



Latest update on backdoor listings and related matters effective 1 October 2019

A. Backdoor listing

HKEx Guidance Letter GL78-14) is codified and revised in New Note 1 to revised Main Board Listing Rule 14.06B (GEM Listing Rule 19.06B).

Under the new Note, the six assessment criteria that HKEx will apply in determining whether an asset acquisition(s) constitutes an attempt to list the acquired assets and a means to circumvent the new listing requirements are:

- a) the size of the acquisition(s) relative to the size of the listed company;
- b) a fundamental change in the listed company's principal business;
- c) the nature and scale of the listed company's business before the acquisition(s) (e.g. whether the listed company is a shell);
- d) the quality of the assets acquired/to be acquired;
- e) a change in control or de facto control of the listed company (other than at the level of its subsidiaries); and
- f) other transactions or arrangements which, together with the asset acquisition or acquisitions, form a series of transactions or arrangements to list the acquired assets.

The HKEx will pay particular attention to the emboldened assessment criteria above but all the factors will be taken into consideration together to look at each case.

De facto Control

In determining whether a change has occurred, the HKEx will consider whether there has been:

1. a change in the listed company's controlling shareholder; or
2. a change in the single largest substantial shareholder who is able to exercise effective control over the listed company, as indicated by factors such as a substantial change to its board of directors and/or senior management.

Factor (e) above (i.e. a change in de facto control) now also provides that where a listed company issues convertible securities with a conversion restriction mechanism aimed at preventing a change in control being triggered under the Takeovers Code, and those securities are issued to an asset vendor as consideration for the sale of assets, the HKEx will consider whether the issue is a means to allow the vendor to gain effective control of the listed company.

A series of transactions

In considering (f) above, the amendments clarify that transactions in "other transactions or arrangements" may include changes in control or de facto control, acquisitions and/or disposals (not just acquisitions). The series of transactions/arrangements criterion has been extended to include transactions within 36 (instead of 24) months. The entire series of transactions and/or arrangements would be treated as if it were one transaction. A disposal may trigger a reverse takeover ruling with respect to a previously completed acquisition in the same series, or a number of smaller acquisitions may form a reverse takeover.



The “series of transactions and/or arrangements” factor is typically applied together with other assessment factors, for example the relative size of the transaction to the listed company, and whether the series of transactions would lead to a fundamental change in the principal business of the listed company.

The guidance letter HKEx-GL 104-19 also makes the following points:

- a. This criterion should not unduly restrict listed companies’ business expansion or diversification that occur over a reasonable period if publicly disclosed information will inform shareholders and the public about listed companies’ business operations and developments.
- b. HKEx will not normally consider a transaction or arrangement outside the three-year period to be part of the series, except where the transactions are clearly related or there are specific concerns regarding circumvention of the reverse takeover rules. The following examples are given:
 - i. a transaction proposed just outside the three-year period which was likely under contemplation within it;
 - ii. if a listed company terminates a proposed acquisition of a target business (or reduces the size of an acquisition) after the HKEx rules it to be a reverse takeover, the HKEx may treat any further acquisitions of the target business outside the three-year period as part of a series; and
 - iii. if a listed company acquires a new business with an option to acquire another target business and the option is exercised more than three years after the original acquisition, the HKEx may consider the acquisitions as a series.
- c. HKEx will normally aggregate acquisitions that are related, such as:
 - i. acquisitions that are in a similar line of business;
 - ii. acquisitions of interests in the same company or group of companies; and
 - iii. acquisitions of businesses from the same or a related party.

Size Tests

The bright line tests of Note 2 to Main Board Listing Rule 14.06B (GEM Listing Rule 19.06B) have been amended to include very substantial acquisition(s) from a listed company’s controlling shareholder within 36 (instead of 24) months from a change in control. In assessing whether the size of acquisitions in a series is substantial, the HKEx will normally compare:

- the aggregate financial figures/ consideration of the acquired assets at their respective acquisition times to:
- the size of the listed company being the lower of its latest published financial figures (i.e. revenue, profits and assets) or market capitalisation: (i) before the first transaction in the series; and (ii) at the time of the last transaction in the series (Guidance Letter HKEx-GL104-19 at paragraph 32).

The above is however guidance only and the HKEx will consider each one case-by-case.

Modification of restriction on disposals after change in control

Disposals by listed issuers may amount to a change of control. The revised rule:



- a. extends the restriction period to carry out a disposal/distribution in specie from 24 months to 36 months;
- b. applies the restriction to distributions in specie amounting to a material disposal of the listed company's business;
- c. extends the restriction to a disposal at the time of the change in control (and not only disposal(s) occurring after the change in control). This rule intends to prevent the use of shell creation structures where a controlling shareholder disposes of its shareholding interest to a new investor, and at the same time buys back a material part of the listed company's principal business; and
- d. disapply the restriction if the remaining group (and not merely assets obtained after the change in control) can satisfy the requirements of Main Board Listing Rule 8.05, 8.05A or 8.05B or GEM Listing Rule 11.12A or 11.14.

Codification of HKEx Guidance Letter GL84-15

New Main Board Listing Rule 14.06D (GEM Listing Rule 19.06D) disallows backdoor listings through large scale issues of securities for cash, if:

- a. there is, or will result in, a change of control or de facto control of the listed company; and
- b. the proceeds will be applied to acquire and/or develop a new business that is expected to be substantially larger than the listed company's existing principal business.

Compliance requirements for reverse takeover

If a transaction constitutes a reverse takeover:

- a. the assets to be acquired by the listed company (together with assets already acquired in a series of transactions or arrangements) (defined as "acquisition targets" in new Main Board Listing Rule 14.04(2A)/ GEM Listing Rule 19.04(2)) must:
 - i. be considered by the HKEx to be suitable for listing (under Main Board Listing Rule 8.04 or GEM Listing Rule 11.06); and
 - ii. meet the financial and trading record requirements for new applicants under Main Board Listing Rule 8.05, 8.05A or 8.05B (GEM Listing Rule 11.12A or 11.14); and
- b. the enlarged group must satisfy all new listing criteria under Main Board Chapter 8 (except Main Board Listing Rule 8.05) or GEM Chapter 11 (other than GEM Listing Rule 11.12A) (under Main Board Listing Rule 14.54/GEM Listing Rule 19.54).

Additional requirements for certain companies

If a reverse takeover is proposed by a listed company that is unable to comply with Main Board Listing Rule 13.24 or GEM Listing Rule 17.26, typically a suspended company, HKEx must additionally be satisfied that there will be sufficient public interest in the business of the acquired assets and the enlarged group (Main Board Listing Rule 14.54 and GEM Listing Rule 19.54).



HKEx Waiver

The HKEx may grant a waiver from strict compliance with the requirements if a reverse takeover involves a series of transactions and/or arrangements and the acquired assets cannot meet the management continuity and/or the ownership continuity and control requirements of Main Board Rule 8.05(1)(b) and (c) (GEM Listing Rule 11.12A(2) and (3)) due to a change in their ownership and management solely as a result of their acquisition by the listed company.

In considering whether to grant a waiver of Rule 8.05(1)(b), the HKEx will consider whether the listed company has the expertise and experience in the relevant business/industry of the acquired assets to ensure their effective management and operation.

Extreme transactions and disclosure and due diligence requirements

“Extreme very substantial acquisitions” under HKEx Guidance Letter GL76-14 have been renamed “extreme transactions” under Main Board Listing Rule 14.06C (GEM Listing Rule 19.06C) and there are additional requirements from an adverse takeover.

To qualify as an “extreme transaction” the following three conditions must also be met:

- a. either
 - i. the listed company has been under the control or de facto control of a person or group of persons for a long period (normally at least 36 months), and the transaction would not result in a change in control or de facto control of the listed company (other than at the level of its subsidiaries); or
 - ii. the listed company has been operating a principal business of a substantial size, which will continue after the transaction. New Guidance Letter GL-104 provides guidance on what constitutes a business “of a substantial size”, which includes a listed company with annual revenue or total asset value of HK\$1 billion according to its latest published financial statements. The HKEx will also take into account the listed company’s financial position, the nature and operating model of its business and its future business plans.
- b. the acquired assets must:
 - i. be suitable for listing under Main Board Listing Rule 8.04 (GEM Listing Rule 11.06); and
 - ii. meet the financial and track record requirements of Main Board Listing Rule 8.05, 8.05A or 8.05B (GEM Listing Rule 11.12A or 11.14).
- c. the enlarged group must meet all the new listing requirements of Chapter 8 of the Main Board Listing Rules (except Listing Rule 8.05) or Chapter 11 of the GEM Listing Rules (except GEM Listing Rule 11.12A).

New Main Board Listing Rule 14.53A (GEM Listing Rule 19.53A) requires a listed company proposing an extreme transaction to:

- a. comply with the requirements for very substantial acquisitions set out in Main Board Listing Rules 14.48 to 14.53 (GEM Listing Rules 19.48 to 19.53). The circular must contain the information required under Main Board Listing Rule 14.69 (GEM Listing Rule 19.69); and
- b. appoint a financial adviser to perform due diligence on the assets subject to the acquisition (and any assets and businesses subject to a series of transactions and/or arrangements, if any). The financial adviser must submit to the HKEx a declaration in relation to the due diligence conducted before the bulk-printing of the circular for the transaction.



Under Listing Rule 13.87B, the financial adviser must be a person licensed or registered for Type 6 regulated activity under the SFO, and permitted under its licence or certificate of registration to undertake sponsor work. The financial adviser is also required to submit to the HKEx an undertaking to comply with the Listing Rules and co-operate in any investigation conducted by the HKEx.

The track record period for an extreme transaction involving a series of transactions and/or arrangements will be three years (for Main Board listed companies) and two years (for GEM listed companies) before the issue of the circular for the latest proposed transaction in the series (new Main Board Listing Rule 14.57A (GEM Listing Rule 19.57A)). The listed company must provide the HKEx with sufficient information to demonstrate that the acquired assets can meet the requirements of Main Board Listing Rule 8.05, 8.05A or 8.05B or GEM Listing Rule 11.12A or 11.14.

B. Changes made to continuing listing criteria

Amendments to Listing Rule 13.24 (GEM Rule 17.26) on sufficiency of operations

The Listing Rules are revised to require a listed company to have a business with a sufficient level of operations and assets of sufficient value to support its operations to warrant its continued listing (revised Main Board Listing Rule 13.24 and GEM Listing Rule 17.26). It is a factual question, each depending on its facts and circumstances of each case.

If the HKEx raises concerns with a listed company about compliance with the rule, the onus is on the company to provide the HKEx with information addressing its concerns and demonstrating its compliance with the rule.

The note to new Main Board Rule 13.24(2) and GEM Rule 17.26(2) adds that the rule also does not apply to the proprietary trading and/or securities investment activities of banking companies (as defined in Listing Rule 14A.88) and insurance companies and securities houses (as defined in Listing Rule 14.04).

Cash company rule

The definition of "short-dated securities" in the cash company Listing Rules (Main Board Rules 14.82 - 14.84 and GEM Listing Rules 19.82 - 19.84) have been amended to include "short term investments", that is investments that are easily convertible into cash.

The note to Main Board Rule 14.82 (GEM Listing Rule 19.82) provides that the HKEx will apply a principle-based approach in determining the listed company's intention holding the assets and the marketability or liquidity of the assets. Short-term investments include bonds, bills and notes with less than one year to maturity, those with a maturity of more than one year intended to be held for less than one year, listed securities that are available for sale, investments that are easily convertible into cash, and advances to third parties that are repayable within one year (excluding trade receivables arising in the listed company's ordinary and usual course of business).

Cash and short-term investments held by a banking company, insurance company or a securities house will not normally be taken into account. However, the exemption for securities houses will not apply if the HKEx has concerns that the listed company is holding cash and short-term investments through a member to circumvent Listing Rule 14.82 (GEM Listing Rule 19.82) on cash companies. For example, a listed company holding excessive cash and/or securities investments cannot circumvent the rule by holding such assets through a group member that is a licensed broker with minimal brokerage operations.

A 12-month transitional period commencing on 1 October 2019 will apply to listed companies that do not comply with revised Main Board Listing Rules 13.24 (sufficiency of operation) or 14.82 (cash company rule) (GEM Rules 19.24 or 19.82) strictly due to the rule amendments.



C. Other amendments

Additional disclosure requirements

There are other changes in the disclosure requirements regarding significant investments and notifiable and connected transactions. Listed companies will be required to disclose in their annual reports details of each securities investment with a value of 5% or more of their total assets as at the year-end date. The details to be included are:

- a. details of each investment, including the name and principal businesses of the underlying company, the number and percentage of shares held and the investment costs;
- b. the fair value of each investment as at the year-end date and its size relative to the listed company's total assets;
- c. the performance of each investment during the year, including any realised and unrealised gain or loss and any dividends received; and
- d. a discussion of the listed company's investment strategy for these significant investments.

Chapters 14 and 14A (GEM Chapters 19 and 20) have been revised to require a listed company to disclose:

- a. in its next annual report the outcome of a guarantee on the financial performance of an acquisition target that is subject to the notifiable or connected transaction requirements (irrespective of whether the guaranteed financial performance is met);
- b. by way of announcement if there is:
 - i. any change to the terms of a guarantee referred to in (a) above; or
 - ii. the actual financial performance of the target acquired fails to meet the guarantee (or the amended guarantee).

The revised HKEx Listing Rules require:

- a. the identities of the parties to notifiable transactions (including extreme transactions and reverse takeovers) to be disclosed in announcements of, and circulars for, notifiable transactions (Main Board Listing Rule 14.58 and GEM Listing Rule 19.58);
- b. connected transaction announcements and circulars to disclose the identities and a description of the principal business activities of the parties to the connected transaction and of their ultimate beneficial owners (Main Board Listing Rules 14A.68(1A) and 14A.70 and GEM Listing Rules 20.68(3) and 20.66).

HKEx has revised the Listing Rules to make clear that where any calculation of the percentage ratios for a transaction produces an anomalous result, or is inappropriate to the listed company's sphere of activities, the HKEx (or the company) can apply an alternative size test it considers appropriate to assess the transaction's materiality under Chapter 14 or 14A (GEM Chapters 19 or 20).

Revenue exemption limited

The revenue exemption from the notifiable transaction requirements is now only available for purchases and sales of securities if they are conducted by members of a listed group that are subject to the supervision of prudential regulators (i.e. banking companies, insurance companies or securities houses) (Main Board Listing Rule 14.04(1)(g) and GEM Listing Rule 19.04(1)(g)).



Requirements for distributions in specie of unlisted assets

Listing Decision LD75-4's requirements for significant distributions in specie of unlisted assets is codified and revised to impose further requirements on a distribution in specie that is equivalent in size to a very substantial disposal (Main Board Listing Rule 14.94 and GEM Listing Rule 19.93).

The requirements for a distribution in specie are that it:

- a. must be approved by independent shareholders in general meeting by at least 75% of the votes attaching to any class of listed securities held by holders voting either in person or by proxy at the meeting;
- b. the number of votes cast against the resolution must not be more than 10% of the votes attaching to any class of listed securities held by holders permitted to vote in person or by proxy at the meeting. Controlling shareholders (or directors (other than independent non-executive directors) and the chief executive, where there is no controlling shareholder) and their respective associates must abstain from voting for the resolution; and
- c. the shareholders (other than the directors (excluding independent non-executive directors), chief executive and controlling shareholders) should be offered a reasonable cash alternative or other reasonable alternative.