The HKEx Issues New Guidance on Cash Companies Rules

Introduction

In view of the recent increasing number of listed companies proposing large scale fundraisings where investors would inject substantial amounts of cash into the companies, The Stock Exchange of Hong Kong (the "**Stock Exchange**") has issued a guidance letter on cash companies rules (HKEx-GL843-15) (the "**Guidance Letter**") on 21 December 2015 to provide guidance on the Stock Exchange's approach to applying the cash company rules in those cases.

Relevant Rules

Under Main Board Rule 14.82 and GEM Rule 19.82, where the assets of a listed issuer (other than an investment company) consist wholly or substantially of cash or short dated securities, it will not be regarded as suitable for listing and trading in its securities will be suspended.

The listed issuer may apply to the Stock Exchange to lift the suspension once it has a business suitable for listing pursuant to Main Board Rule 14.84 or GEM Rule 19.84. However, such application will be treated as if it were a new listing application, which implies that the listed issuer is required to comply with all the new listing requirements and issue a full listing document.

Guidance

As a general principle, there is no prescribed quantitative threshold in the cash company rules for assessing whether a company's assets consist substantially of cash. Nevertheless, the expression of "wholly or substantially" is understood as meaning in the main or as of the greater part. Accordingly, a company with less than half (50%) of its assets being cash as a result of a fundraising would not normally be regarded to have assets consisting wholly or substantially of cash.

However, it is noteworthy that, the Stock Exchange does not merely focus on the analysis of the company's cash to assets ratio. Other factors, such as the background facts and circumstances of the company's business, operation and financial position, are also relevant to the Stock Exchange's assessment.

Features of the proposed fundraisings

In the Guidance Letter, the Stock Exchange noted that the proposed large scale fundraisings share all or some of the following special features:

1. The size of the fundraising would be very significant to the company and would bear little or no correlation with the needs of the company's existing principal business.
2. Funds raised would be used in largely greenfield operations of new businesses with little or no relation to the company's existing principal business. In some cases, these new businesses were the same as or similar to the businesses of the investor(s). There were also cases where the company claimed to have started the new businesses shortly before the proposed fundraisings (e.g. obtained a money lending licence or acquired a small size money lending company).
3. The investor(s) would obtain control (or *de facto* control) of the company and would intend to manage the new businesses. In most cases, a significant proportion of the directors of the company would resign and new directors would be nominated by the investor(s).
4. The company would employ the cash obtained from the fundraising to proceed to operate new businesses which are expected to be substantially larger than the original business.

The Stock Exchange's views

The Stock Exchange is of the view that the proposed fundraisings would result in the companies' assets consisting substantially of cash upon completion and the investors were in effect listing, through the listed company, new businesses which would not have otherwise met the new listing requirements (due to lack of a track record which would render these businesses unsuitable for listing).

The Stock Exchange also noted that, some companies have tried to address the cash company concerns by providing further details about their business plans and/or signing agreements to commit the use of the cash proceeds. These companies took the view that these actions would allow them to exclude those cash proceeds to be utilised pursuant to such agreements from their cash position upon completion of the fundraisings. The Stock Exchange does not agree with this view as the entering into of such agreements does not address the cash company concern.

Under the cash company rules, the cash company assessment is made based on a company's cash balance as a result of the fundraisings and the situation as pertaining at the date of completion of the fundraising. The company cannot rely on the future intended use of proceeds, whether by way of legally binding agreement or otherwise, as a means of reducing the cash level at completion for the purpose of the rules. Once the company is considered to have its assets consisting substantially of cash, the Stock Exchange is required to evaluate the business plans (including the intended use of proceeds) *as* if it were a new listing application.

Administrative Matters

Pursuant to the Main Board Rule 13.52(2)(c) and GEM Rule 17.53(2)(c), announcements relating to cash companies have to be pre-vetted by the Stock Exchange. Therefore, for prudence sake, it is advisable for listed companies intending to undertake large scale fundraisings to consult the Stock Exchange at the earliest possible opportunity to seek guidance on the application of the cash company rules in individual cases.

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