

Corporate Finance

Summary of updates to HKEx guidance materials

Introduction

In recent years, The Stock Exchange of Hong Kong Limited (the “**Stock Exchange**”) has issued an increasing number of guidance and related materials (the “**Guidance Materials**”). On 28 February 2020, the Stock Exchange announced some updates on the Guidance Materials for promoting consistency of its guidance with the major updates set out as follows.

Important Updates

Meaning of “ownership continuity and control” where there is no controlling shareholder
The Stock Exchange integrates its guidance in the Frequently Asked Questions (“**FAQ**”) to the Guidance Letter GL89-16. Where a listing applicant does not have a controlling shareholder or a group of controlling shareholders, the ownership continuity and control requirement applies to the single largest shareholder or the group of shareholders being considered as the single largest shareholder.

More comprehensive guidance for Mineral Companies
To provide more comprehensive guidance to listing applicants which are Mineral Companies (as defined under the Rules Governing the Listing of Securities on the Stock Exchange (the “**Listing Rules**”)), the Stock Exchange consolidates its guidance in the Guidance Letter GL52-13 with the following major amendments:

1. *Specific disclosure requirements*

More factors which the Stock Exchange may consider in assessing whether sufficient disclosure in the prospectus and the Competent Persons’ Report (“**CPR**”) is made are included and some disclosure requirements for certain sections of the prospectus are amended.

2. *Assessment of the applicability of the exemption from the financial tests for listing under Rule 8.05 of the Listing Rules*

Pursuant to Rule 18.04 of the Listing Rules, if a listing applicant which is a Mineral Company is unable to satisfy the financial tests set out under Rule 8.05 of the Listing Rules, it may nevertheless apply to be listed if the Stock Exchange is satisfied that its

management is sufficiently experienced in its exploration and/or extraction activity. The revised guidance letter elaborates on factors which may be considered by the Stock Exchange in assessing the applicability of the exemption, namely (i) sufficient relevant experience and (ii) clear path to commercial production.

3. *Assessment criteria of the applicability of alternative reporting and waiver in relation to petroleum resources and reserves*

The Stock Exchange elaborates on (i) the factors considered by the Stock Exchange in accepting alternative reporting standards; (ii) the circumstances under which the Stock Exchange will allow presentation of net present value on pre-tax basis; and (iii) the circumstances where the Stock Exchange will grant a waiver under Rule 18.33(6) of the Listing Rules for disclosure of economic values of Possible Reserves, Contingent Reserves or Perspective Resources (as defined under the Listing Rules).

4. *Waiver in relation to the disclosure of mining assets*

Circumstances under which the Stock Exchange allows applicants to exclude part of their mining assets in a CPR under Rule 18.05(1) of the Listing Rules are set out in the revised guidance letter. It is also made clear that such waiver applicants are required to make alternative prospectus disclosure, annual update on the stage of development of such mining assets and a CPR once the relevant information is available.

Specific guidance on due diligence for distributorship business model

The amendments in Guidance Letter GL36-12 provide more specific guidance for due diligence to be conducted by sponsors and the appropriate prospectus disclosure for listing applicants with a distributorship business model in the following major areas:

1. *Adding definitions of “distributors” and “sub-distributors”*

The definitions of “distributors” and “sub-distributors” are added. “Distributors” refers to those who contractually resell, or are reasonably expected to resell the applicant’s products, which include franchisees and consignees, while “sub-distributors” are other intermediaries who purchase an applicant’s product from its distributors to resell.

It is also made clear that retail buyers who are not expected to further resell the applicant’s products will not normally be considered a distributor even if they occasionally resell the products to other parties.

2. *Adding key risks arising from a distributorship model*

a. Channel stuffing

The risk of channel stuffing refers to the situation where an applicant's distributors or sub-distributors are subject to mandatory sales targets and/or unusually long return policies, and there is a risk that the products are not reaching end-customers but remain in the applicant's distribution network. In this case, as sales may not accurately reflect actual end-customer demand, relevant due diligence and prospectus disclosure should be undertaken.

b. Recoverability of accounts receivables

In the event that there are long outstanding accounts receivables from distributors or sub-distributors and/or a substantial increase in aged accounts receivables and debtors' turnover days, the applicant's directors and sponsors are required to provide views on whether the applicant's credit management policy is appropriate and the adequacy of the provisions for accounts receivables. There should also be prospectus disclosure on the applicant's level of direct and indirect control over its distributors or sub-distributors and the relevant risk factors.

3. *New guidance relating to distribution through social media platforms*

Social media platforms and key opinion leaders have become popular means to promote and sell goods. If the applicant distributes goods through such means, sponsors are expected to perform sufficient due diligence as appropriate.

Other important amendments

In addition to the amendments to the Guidance Letters mentioned above, the Stock Exchange also revised eight sets of FAQs Series, including:

- FAQ Series 1 (rule requirements regarding listing criteria issues);
- FAQ Series 5 (rule amendments regarding GEM Review);
- FAQ Series 8 (rule amendments regarding the 2008 combined consultation);
- FAQ Series 20 (rule requirements regarding notifiable transactions, connected transactions and issues of securities);

- FAQ Series 24 (listing rule changes to complement the Securities and Futures Commission's New Sponsor Regulation effective on 1 October 2013);
- FAQ Series 26 (questions regarding the new Companies Ordinance and its impact on issuers);
- FAQ Series 31 (questions regarding the review of Listing Rules on disclosure of financial information with reference to the new Companies Ordinance and Hong Kong financial reporting standards and proposed minor/housekeeping rule amendments); and
- FAQ No. 008-2017 to 022-2017 and 023-2018 (questions regarding the review of GEM and changes to the GEM and Main Board listing rules).

The Stock Exchange also withdrew a number of outdated Listing Decisions (LD106-1, LD46-3, LD21-2 and LD12-3) and Interpretative Letters (RL4-05, RL6-05 and RL22-07).

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Important: 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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