

■ Guide to Listing: A Summary of Key Requirements in Hong Kong

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This guide is designed to provide background information in relation to a listing on the Main Board of the Stock Exchange of Hong Kong. It does not address the Growth Enterprise Market (GEM) of the Stock Exchange of Hong Kong though much of the content in this guide will be applicable. This guide is not intended to be an exhaustive review of laws and regulations applicable to a listing. It is not intended to be legal advice and should not be relied upon as such. Anyone who may have particular concerns as to the laws or regulations applicable to them in relation to their own circumstances should seek specific legal advice.

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Guide to Listing

A Summary of Key Requirements in Hong Kong

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Hong Kong is an international financial center with deep capital markets tied to China. Total equity funds raised through initial public offerings (“IPOs”) in 2010 exceeded US\$57 billion, ranking the Stock Exchange of Hong Kong (“SEHK”) as the global leader in equity fund raising through IPOs. By comparison, in the same year, total equity funds raised through IPOs on the New York Stock Exchange and Stock Exchange of London was less than US\$35 billion and US\$16 billion, respectively.

Companies around the world outside of the Greater China region are increasingly looking towards Hong Kong as a listing venue, particularly where such companies have significant China operations. In 2010, Russian aluminum maker United Co. Rusal and French cosmetics company L’Occitane listed on the SEHK. In 2011, commodities producer Glencore listed on the SEHK and luxury fashion house Prada and baggage maker Samsonite have, as of writing, already begun the listing process.

The Decision to List

For shareholders, listing brings more liquidity and increased freedom to deal with their shareholding interest.

For a company, a listing means greater public scrutiny and accountability, some loss of control and flexibility with the introduction of public shareholders as well as ongoing costs (both in terms of management time and money) to comply with regulatory requirements.

However, a listing brings a number of advantages to the company:

- *Access to Capital.* Listing facilitates access to capital, both locally and overseas. The prospect of listing is attractive to private equity investors who, in the period of months and years prior to a listing, often take an equity interest in potential listed companies. Moreover, the actual listing itself is a capital raising process. Finally, listing brings access to a broader range of opportunities for future financing and facilitates exposure to a wider range of investors.
- *Enhanced Ability to Recruit and Retain Employees.* Listing enhances opportunities for employee compensation through share options which can, in turn, enhance the ability to recruit and retain employees.
- *Improved ability to complete mergers and acquisitions.* Listing enables a company to complete mergers and acquisitions, both through share swaps and through the ability to raise funds required to complete deals through the sale of additional equity.
- *Higher Profile and Greater Prestige.* Listing will often increase a company’s exposure to the public and can enhance credibility and prestige.

Hong Kong’s Advantages

China’s International Financial Center

Hong Kong is widely perceived as the financial gateway to China and China is widely perceived as the next

While markets in Shanghai and Shenzhen remain in many ways closed to international investors, the Hong Kong market enjoys a broad international base of investors who have historically welcomed companies with a strong China story, whether in the form of a strong brand presence in China or strong levels of business with China.

economic superpower. While markets in Shanghai and Shenzhen remain in many ways closed to international investors, the Hong Kong market enjoys a broad international base of investors who have historically welcomed companies with a strong China story, whether in the form of a strong brand presence in China or strong levels of business with China. At the same time, there is growing evidence that the Hong Kong market may serve as the gateway for international companies to tap the Chinese capital markets.

Balanced and Credible Legal Framework

Hong Kong offers a legal and regulatory framework that is both balanced and credible:

- *Certainty of Law.* Hong Kong law is based on the English common law and as a result, benefits from centuries of jurisprudence. At the same time, Hong Kong courts provide independent and impartial dispute resolution. As a result, in comparison to other Chinese markets, the Hong Kong market offers greater confidence for international investors.
- *Friendly Regulatory Framework.* The Hong Kong regulatory framework applicable to listed companies is relatively friendly. Hong Kong does not establish Sarbanes-Oxley like compliance requirements similar to those in the United States. These requirements have been criticized for a number of reasons, including significant compliance costs and auditing fees.
- *Less Litigious Environment.* Compared to overseas markets such as the United States, Hong Kong offers a

far less litigious environment. According to the Hong Kong judiciary, the High Court handled 26,940 civil cases in 2009 compared to 141,119 during one quarter of the same year handled by the New York City Civil Court. Accordingly, Hong Kong listed companies are less likely to become embroiled in civil litigation and to suffer to the same extent from associated defense costs.

Qualifications for Listing

Broadly, to qualify for listing on the Main Board of the SEHK, a company must satisfy the SEHK that it and its businesses are suitable for listing and, unless waived or modified by the SEHK, the company must have a track record that meets prescribed benchmarks.

Suitability

There is no single test of suitability. However, where a company fails to comply with laws and regulations and such non-compliance may affect the viability of the business of the company, it is unlikely that the SEHK would regard the company as being suitable for listing.

Similarly, where a company is unable to carry on its business independently, the SEHK is unlikely to regard the company as being suitable for listing. Thus, for example, the SEHK may regard as unsuitable a company which relies predominantly on a single customer or a single supplier, particularly where this reliance is expected to continue post-listing and such reliance is unusual within the company's industry. Equally, for

To satisfy the “profits test”, a company (or its group) must have profits of (i) not less than HK\$20 million in the most recent financial year, and (ii) not less than HK\$30 million in aggregate in the two years preceding the most recent financial year... At the same time, the company (or its group) must have been under substantially the same ownership during this three year track record period.

example, the SEHK may regard as unsuitable for listing a company which relies on support from a related party.

A company whose assets consist wholly or substantially of cash or short-dated securities (such as bonds, bills or notes which have less than one year to maturity), will not normally be regarded as suitable for listing except where the company is an investment company (*i.e.* a collective investment scheme) or the company or group is solely and mainly engaged in the securities brokerage businesses.

Track Record

To meet SEHK minimum track record requirements, a company must satisfy one of three tests, namely the “profits test”, the “market capitalization/revenue/cash flow test”, or the “market capitalization/revenue test”.

- *Profits Test.* To satisfy the “profits test”, a company (or its group) must have profits of (i) not less than HK\$20 million in the most recent financial year, and (ii) not less than HK\$30 million in aggregate in the two years preceding the most recent financial year. For this purpose, any income or loss of the company, or its group, generated by activities outside the ordinary and usual course of its business is ignored. In this regard, the SEHK has discounted profits derived from connected transactions and the spin-off of companies but has accepted profits from joint ventures and deferred tax credits.

- *Market Capitalization, Revenue and Cash Flow Test.* To satisfy the “market capitalization/revenue/cash flow test”, a company must have (i) a market capitalization of at least HK\$2 billion at the time of listing, (ii) revenue of at least HK\$500 million in the most recent audited financial year, and (iii) positive cash flow from its operating activities (or those of its group) of at least HK\$100 million in aggregate for the three preceding financial years.

- *Market Capitalization and Revenue Test.* The “market capitalization/revenue test” requires that a company have (i) a market capitalization of at least HK\$4 billion at the time of listing, and (ii) revenue of at least HK\$500 million in its most recent audited financial year.

Under each test, the company (or its group) must have been under substantially the same ownership for at least the most recent audited financial year and must have a trading record of not less than three years under substantially the same core management. Whether or not the company meets these requirements for management and ownership continuity depends in practice in part on whether the SEHK considers that it and investors are able to make an informed assessment of the ability of company management to manage the business and the likely performance of that business in the future.

However, the SEHK has agreed to relax the requirement for management continuity and trading record in a number of cases.

Lawyers for the company play a key role in advising on and implementing any pre-IPO restructuring of the company's group and negotiating any pre-IPO investments. They will advise the company on the SEHK Listing Rules and laws applicable to the listing and the share offer and will draft the listing application and the prospectus (known as a listing document).

- *Very Substantial Businesses.* In the case of the market capitalization/revenue test, the SEHK may accept a shorter trading period or period of management continuity (the minimum being management continuity during the most recent audited financial year) where it is satisfied that the directors and management of the new applicant have sufficient and satisfactory experience of at least three years in the line of business and industry of the company.
- *Natural Resource Companies.* The SEHK may accept a shorter trading record period or may vary or waive the financial tests set out above in the case of a natural resources company (*i.e.* a company in which 25 per cent. or more of its business and that of its group is the exploration or extraction of minerals or petroleum) which meets the following requirements: (i) the company has the right to actively participate in the exploration for or extraction of natural resources, (ii) the company has a portfolio of natural resources, which, based on prescribed criteria and in simplified terms, are economically viable, (iii) the company has available working capital for 125 per cent. of the group's requirements for the next 12 months, and (iv) senior management has sufficient experience in the exploration or extraction activity of the company with individuals relied upon having at least 5 years of relevant experience.
- *Project Companies.* The SEHK may accept a shorter trading period in the case of newly formed project companies. For this purpose, project

companies include companies formed to construct a major infrastructure project (*e.g.* construction of roads, bridges, tunnels, railways, mass transit systems, water and sewage systems, power plants, telecommunication systems, seaports and airports). To qualify, (i) such companies must undertake the development of the project (not merely finance the project) and no other business, (ii) the project must be carried out under a substantial long term concession or mandate (typically a contract for at least 15 years with a capital cost of at least HK\$1 billion), (iii) the proceeds of a listing will be used to finance the construction of the project rather than to repay debt, and (iv) the directors and management of such companies must have sufficient and satisfactory experience of at least 3 years in the relevant business.

Assembling the Team

A first and critical step for a company in the IPO process is to assemble a team of professionals and to assign executives within the company to work with these professionals. The executives should have sufficient seniority to facilitate the flow of information between these professionals and the company and to make decisions concerning structural issues.

Lawyers

Separate law firms should advise the prospective company on the one hand and the sponsor and underwriter on the other.

Lawyers for the sponsor will advise the sponsor so as to enable it to discharge its regulatory obligations. They will play a key role in the sponsor's due diligence of the company, checking the company's compliance with the SEHK Listing Rules and leading the process of verifying the listing document.

Lawyers for the company play a key role in advising on and implementing any pre-IPO restructuring of the company's group and negotiating any pre-IPO investments. They will advise the company on the SEHK Listing Rules and laws applicable to the listing and the share offer and will draft the listing application and the prospectus (known as a listing document). They will negotiate the underwriting agreement and provide the company with crucial independent advice.

Lawyers for the sponsor will advise the sponsor so as to enable it to discharge its regulatory obligations. They will play a key role in the sponsor's due diligence of the company, checking the company's compliance with the SEHK Listing Rules and leading the process of verifying the listing document. Where the sponsor acts as an underwriter, they will represent the sponsor in negotiating the underwriting agreement.

If the listing includes an offering in jurisdictions outside Hong Kong, lawyers qualified in those jurisdictions should advise on requirements in those jurisdictions. If the company is incorporated outside of Hong Kong, lawyers qualified in that jurisdiction should advise on corporate matters applicable in that jurisdiction. If the company has business activities in jurisdictions outside of Hong Kong, lawyers qualified in those jurisdictions should assist with local due diligence and advise on local legal and regulatory requirements affecting the listing (e.g. companies with business activities in China may be required to obtain state approvals).

Sponsor

The company's sponsor advises the company on the structure, timing and pricing of the IPO. It liaises with the SEHK and in this regard, it lodges the formal listing application and all supporting documents with the SEHK and deals with the SEHK on all matters arising in connection with the application.

The sponsor owes particular regulatory duties to the SEHK. It must assess the suitability of the company for listing and the SEHK expects the sponsor to conduct due diligence to satisfy itself that:

- the company complies with the SEHK Listing Rules and has in place systems and procedures to comply with the SEHK Listing Rules,
- the listing document contains sufficient information to enable a reasonable person to form a valid and justifiable opinion of the condition of the company,
- expert opinions in the listing document are based on fair, reasonable and complete assumptions and are issued by appropriately qualified experts independent of the company, and
- the directors of the company have the experience, qualifications and competence to manage the company's business, to comply with the SEHK Listing Rules and to undertake their individual roles.

The sponsor will often serve as the lead underwriter for the securities which are the subject of the offer and

Ahead of listing, a company will often undergo a reorganization, not only to ensure compliance with the SEHK Listing Rules but also to ensure that the structure of the business meets public market expectations. Broadly, a pre-IPO reorganization will involve a reorganization of the corporate group, changes in corporate governance and internal controls and a restructuring of the capital structure of the company.

listing and accordingly, as the key distributor of these securities. As an underwriter, it will be responsible for subscribing for any securities which are not sold under the offer. The SEHK reserves the right to reject a listing application where it is not satisfied that an underwriter will be able to meet its underwriting commitment.

Typically, the sponsor is an SFC regulated investment bank independent of the company applying for listing.

Compliance Adviser

Following listing, a company must appoint a compliance adviser to assist the company in complying with the SEHK Listing Rules. A sponsor may serve as the compliance adviser but frequently, this role is undertaken by a different SFC regulated investment bank.

Accountants

The listing document must include an accountant's report containing, amongst other things, the company's financial results, a balance sheet, a cash flow statement and a statement of changes in equity. The report must be prepared to a standard comparable to that required in Hong Kong or under International Standards on Auditing or China Auditing Standards.

The accountants must be qualified under Hong Kong law for appointment as auditors of a company to be listed. However, in the case of a PRC company, the SEHK may accept accountants approved by the

China Ministry of Finance and the China Securities Regulatory Commission. The accountants must be independent of the company.

Other Parties

Other parties to a listing will include (i) the registrar, who will maintain the register of shareholders, (ii) property valuers, who will prepare the valuations of the company's interest in land and buildings as required by the SEHK Listing Rules, (iii) receiving bankers, who receive and process share applications, (iv) printers, and (v) public relations firms.

Pre-IPO Reorganization

Ahead of listing, a company will often undergo a reorganization, not only to ensure compliance with the SEHK Listing Rules but also to ensure that the structure of the business meets public market expectations. Broadly, a pre-IPO reorganization will involve a reorganization of the corporate group, changes in corporate governance and internal controls and a restructuring of the capital structure of the company.

Corporate Group

Holding Company for Listing

A company applying for listing must be incorporated in Hong Kong or a jurisdiction where the standards of shareholder protection are at least equivalent to those

[A] company should consider its group structure, including which business divisions to include in the listing and how business operations should be divided amongst legal entities. Most significantly, a company should consider whether the inclusion or exclusion of certain businesses may positively or negatively affect the ability to market the securities offer and to comply with track record and other requirements...

provided in Hong Kong. Thus, as part of a pre-IPO reorganization, the company's lawyers will consider the holding structure of the company's business with a view to determining which legal entity in which jurisdiction will list.

It is common to create a new top level holding company in a jurisdiction which is known to be acceptable to the SEHK to serve as the listing vehicle. Overseas jurisdictions which are expressly permitted under the SEHK Listing Rules include Bermuda, the Cayman Islands and the PRC.

However, it may be nevertheless be possible to list a company which is incorporated neither in Hong Kong nor these jurisdictions. In this case, the company will need to demonstrate that the company laws in the jurisdiction of its incorporation afford protection equivalent to that available in Hong Kong. Where applicable company laws do not, the SEHK may nevertheless accept the jurisdiction if the company amends its constitutional documents to provide equivalent protection. As of the date of this guide, the SEHK has also accepted Australia, the British Virgin Islands, Canada (Ontario and British Columbia), Cyprus, Germany, Jersey, Luxembourg, Singapore, Italy and the UK.

Depending on location, overseas companies may be restricted to an extent from listing on the SEHK due to local regulations. In particular, companies incorporated in the US should consult local legal advice on possible domestic securities law issues.

Group Restructuring Considerations

Apart from deciding which legal entity to list, a company should consider its group structure, including which business divisions to include in the listing and how business operations should be divided amongst legal entities. Most significantly, a company should consider (i) whether the inclusion or exclusion of certain businesses may positively or negatively affect the ability to market the securities offer and to comply with track record and other requirements under the SEHK Listing Rules, and (ii) whether the business to be listed is capable of operating independently of its controlling shareholders. It may be desirable at this time to look as well at whether certain high-risk businesses should be ring-fenced and whether holding arrangements appropriate for tax efficiency in a private company context remain appropriate.

A group reorganization may involve the incorporation of new subsidiaries or holding companies, the transfer of assets from one legal entity to another, the conversion of a legal entity from one form to another and the winding-up of some legal entities. These activities may take some time to complete, particularly if third party consents are required.

Legal and regulatory considerations relevant to a pre-IPO group reorganization will include:

- *General.* A pre-IPO reorganization may trigger a broad range of legal issues. For example, asset transfers may be subject to creditor protection

A company should consider whether it (together with its corporate group) has all legal and contractual rights necessary to conduct its business properly following listing and whether the arrangements it has with its employees, shareholders, suppliers and customers are appropriate.

laws. Share transfers may be subject to restrictions under company law on a company providing financial assistance for the acquisition of its shares. Transfers generally may incur stamp duty or other transfer taxes.

- *Acquisitions of new businesses.* If a company acquires a new business which forms a material part of the company's business, materially contributes to its profits, or is dissimilar to its previous business activities, the SEHK may take the view that the company's track record for the purposes of the 3 year track record requirement begins from the date of the acquisition. This would delay a listing until the company could satisfy the 3 year track record period.
- *Spin-offs.* The SEHK Listing Rules prohibit a company from spinning-off of its group assets wholly or partly by their separate listing on the SEHK within three years of the company's original listing. Furthermore, following such period, any spin-off may need to comply with various requirements, such as shareholder approval. Accordingly, a company may wish to spin-off such assets from the company prior to listing.
- *Competing business.* A controlling shareholder of the company to be listed who has an interest in any business which competes or is likely to compete with the company's business will have to demonstrate to the SEHK that the company is capable of carrying on business independently of, and at arm's length from the excluded business.
- *Connected transactions.* If operations or other assets of a company are excluded from the group to be listed and those operations will do business with or those assets are required by the listed group after listing, these arrangements may be regarded as continuing connected transactions under the SEHK Listing Rules. Continuing connected transactions may include, for example, leases and supply agreements. Depending on their size and nature, the SEHK Listing Rules may require that they be (i) evidenced by written agreements entered into on an arm's length basis, (ii) subject, except in special circumstances, to a maximum time period of 3 years, and (iii) subject to a cap in terms of their maximum aggregate annual value. SEHK approval may be required at the time of listing for these connected transactions and independent shareholder approval may be required to approve renewals of these transactions. Generally, a company will wish to reduce its reliance on connected transactions as it reorganizes for an IPO.
- *Transactions at undervalue.* The transfer of assets from one legal entity to another as part of a reorganization will be subject to both tax and insolvency law considerations. Where the transfer takes place at undervalue, tax authorities may challenge any tax benefit arising as a result thereof. Similarly, should the legal entity receiving less than full value become insolvent in the future, the liquidator for the entity may challenge the transaction.

The SEHK requires that a listed company have in place procedures, systems and controls (including accounting and management systems) which enable the company's directors to make a proper assessment of the financial position and prospects of the company.

- *Holding structure.* A company will wish to adopt the most tax efficient holding structure for its business. At the same time, it must ensure that the holding structure complies with foreign ownership restrictions and requirements for regulatory licenses, registrations or authorizations and that the holding structure will enable the accountants to prepare their report in a manner consistent with the track record requirement.

Other Restructuring Considerations

A company should consider whether it (together with its corporate group) has all legal and contractual rights necessary to conduct its business properly following listing and whether the arrangements it has with its employees, shareholders, suppliers and customers are appropriate. Particular attention should be given to the following:

- *Constitutional documents.* The company should amend its constitutional documents as necessary to comply with the SEHK Listing Rules. Articles or other provisions of constitutional documents that may be appropriate for a private company (e.g. restrictions on share transfers) may be entirely inappropriate for a public company.
- *Title to assets.* The company should ensure that it has good and valid legal title to, or otherwise has the right to use, all assets required to conduct its business.
- *Intellectual property rights.* The company should ensure that it owns or has the right to use all intellectual property required to operate its business. Where intellectual property is a material asset of the company, it should ensure that appropriate measures are taken to register or otherwise secure its rights in the intellectual property. Where registration is not possible, the company should consider putting in place confidentiality or other agreements as may be necessary to protect its intellectual property.
- *Material contracts.* The company should properly document its arrangements with key counterparties and should ensure that these arrangements are not only valid and enforceable but appropriate for a listed company. Where new documentation may be required the company may need to obtain the consent of each counterparty and potentially the consent of third parties.
- *Employment arrangements.* The company should document its employment and service arrangements with key employees, officers and consultants.

Governance and Internal Controls

The SEHK requires that a listed company have in place procedures, systems and controls (including accounting and management systems) which enable the company's directors to make a proper assessment of the financial position and prospects of the company.

Directors of a listed company are collectively responsible for the management and operations of the company and collectively and individually for compliance by the company with the SEHK Listing Rules. Every director must satisfy the SEHK that he has the character, experience and integrity and is able to demonstrate a standard of competence commensurate with his position as a director of a listed company.

Management Presence in Hong Kong

A company applying for a primary listing on the SEHK must have a sufficient management presence in Hong Kong. This will normally mean that at least two of its executive directors must be ordinarily resident in Hong Kong.

However, the SEHK may, at its discretion, waive this requirement for a PRC company where there are adequate arrangements for maintaining regular communication with the SEHK. In this regard, the SEHK will take into account the company's compliance adviser's access to the company's authorised representatives, directors and other officers and the accessibility by the SEHK of the alternates to the company's authorised representatives.

Directors

Directors of a listed company are collectively responsible for the management and operations of the company and collectively and individually for compliance by the company with the SEHK Listing Rules. Every director must satisfy the SEHK that he has the character, experience and integrity and is able to demonstrate a standard of competence commensurate with his position as a director of a listed company.

Directors must meet obligations both under the law and under the SEHK Listing Rules. These obligations include:

- *Fiduciary duties.* Directors should (i) act honestly and in good faith in the interests of the company

as a whole and for a proper purpose, (ii) be answerable to the company for the application or misapplication of its assets, (iii) avoid actual and potential conflicts of interest and duty, and (iv) disclose fully and fairly his interests in contracts with the listed company.

- *Duties of care.* Directors should apply such degree of skill, care and diligence as may reasonably be expected of a person of his knowledge and experience and holding his office within the company.

Every board of directors of a listed company must include at least 3 independent non-executive directors, at least one of whom must have appropriate professional qualifications or accounting or related financial management expertise.

Audit Committee

Every listed company must establish an audit committee comprised only of non-executive directors. The committee should have at least 3 members, one of whom is an independent non-executive director with appropriate professional qualifications or accounting or related financial management expertise. The chairman of the committee must be an independent non-executive director.

Nomination and Remuneration Committees

The SEHK recommends that every listed company establish a nomination committee to make recommendations as to board appointments and a

Prior to listing, a company will normally reorganize its capital structure so that its securities may be effectively marketed and efficiently subscribed to by investors. This may involve a simplification of the share capital structure into a single class of shares as well as conversion of outstanding shareholder debt into equity.

remuneration committee to make recommendations as to the remuneration of directors and senior management. The majority of the members of these committees should comprise independent non-executive directors. Listed companies who do not establish these committees are required to disclose and justify the basis for not doing so.

Company Secretary

Generally, a listed company must have a company secretary who has the requisite knowledge and experience to discharge the functions of a secretary of the company. In this regard, the company secretary must either be a solicitor, barrister or a professional accountant, or an individual who, by virtue of his academic or professional qualifications or relevant experience is, in the opinion of the SEHK, capable of discharging those functions.

Except in the case of a PRC listed company, the SEHK generally requires that the company secretary be ordinarily resident in Hong Kong.

Authorized Representatives

The SEHK requires that every listed company appoint two authorised representatives to act at all times as the company's principal channel of communication with the SEHK. The two authorised representatives must be either two directors or a director and the company's secretary unless the SEHK, in exceptional circumstances, agrees otherwise.

Capital Structure

Prior to listing, a company will normally reorganize its capital structure so that its securities may be effectively marketed and efficiently subscribed to by investors. This may involve a simplification of the share capital structure into a single class of shares as well as conversion of outstanding shareholder debt into equity.

Offer Size

The company will wish to consider the appropriate size of the share issuance under the IPO, bearing in mind that generally, a newly listed company may not issue further shares (or issue securities convertible into shares) in the 6 month period following listing.

Rights of Capital

Broadly, all shares in a listed company should carry voting rights which bear a reasonable relationship to the equity interest represented by such shares. Thus, for example, it is not possible for controlling shareholders to hold special shares with super voting powers.

Pre-IPO Investments

The period leading up to an IPO may see pre-IPO investments in a company to raise capital as well as to add credibility and management experience. Where these investments place pre-IPO investors in a position of advantage, they may affect the ability of the company to list.

Listing on the SEHK is often achieved by way of an offer for subscription targeted at the retail public in Hong Kong. Such an offer may be made in conjunction with an international institutional share placement.

In principle, holders of listed securities must be treated fairly and equally. Whilst there is no bright line test and each case is determined on its own merits, in general terms, the greater the level of real investment risk assumed by the pre-IPO investor (often measured by the time period between investment and listing) and the greater the benefit brought by the pre-IPO investor to the listing applicant, the more likely it is that particular rights will survive. These rights may include, for example, a right to acquire shares to be listed at a discount to the IPO price (e.g. by way of conversion at a prescribed price in the case of convertible securities) as well as the right to appoint a director and to veto certain corporate actions (such as the petitioning for a winding up, amendments to constitutional documents, declaration of dividends, the sale of a part of the company's business and changes in directors).

Under interim guidance issued by the SEHK, in the absence of exceptional circumstances, pre-IPO investments should be completed (i.e. funds irrevocably settled and received by the unlisted company) 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 listed company's securities.

Structure of Listing

Listing on the SEHK is often achieved by way of an offer for subscription targeted at the retail public in

Hong Kong. Such an offer may be made in conjunction with an international institutional share placement.

Offer for Subscription

An offer for subscription is an offer to the public by or on behalf of a company of its own shares for subscription. In an offer for subscription, the company issues a prospectus and a form of application for shares. Investors who wish to subscribe for shares apply for shares on the form of application. An offer for subscription must be fully underwritten.

Placing

A share placement is the obtaining of subscriptions for or the sale of shares by a company or intermediary, typically an investment bank, primarily from or to persons selected or approved by the company or intermediary. Typically, the subscribers will be institutional clients of the intermediary.

The SEHK will not permit a company to be listed by way of a placing if there is likely to be significant public demand for the securities. In this regard, where, as is commonly the case, a share placement occurs in conjunction with an offer for subscription, the SEHK dictates the proportion of shares to be made available under the placing tranche and the public subscription tranche based upon the demand in the latter. As a starting point, a minimum of 10 per cent. of the shares offered in the IPO must be offered to the public subscription tranche. However, if the public subscription tranche is oversubscribed:

For controlling shareholders, an IPO may represent an opportunity to realize some of their holdings in the listed company. The SEHK Listing Rules permit shareholders to offer their shares for sale as part of the IPO but restrict dealings by controlling shareholders both before and after listing.

- *Thirty Percent Public Allocation.* The public subscription allocation must rise to 30 per cent. if total demand for shares in the public subscription tranche is 15 times but less than 50 times the initial number of shares allocated to the public subscription tranche;
- *Forty Percent Public Allocation.* The public subscription allocation must rise to 40 per cent. if total demand for shares in the public subscription tranche is 50 times but less than 100 times the initial number of shares allocated to the public subscription tranche; and
- *Fifty Percent Public Allocation.* The public subscription allocation must rise to 50 per cent. if total demand for shares in the public subscription tranche is over 100 times the initial number of shares allocated to the public subscription tranche.
- *Connected Person Dealings.* The SEHK generally prohibits a connected person from dealing in the shares for which listing is sought in the period from 4 clear business days before the expected hearing date of a listing application until the date listing is granted.
- *Lock-Ups.* The SEHK prohibits a controlling shareholder from disposing of his shareholdings in the 6 month period following listing and from reducing his level of shareholdings so that he ceases to be a controlling shareholder in the 12 month period post-listing. This does not prevent the controlling shareholder during this lock-up period from granting a security interest over his shareholdings during this time period to secure a *bona fide* commercial loan. Equally, this does not prevent the controlling shareholder from lending his shares to an underwriter pursuant to an over-allotment option as part of the IPO. The underwriters may impose lock-ups which are more restrictive than those imposed by the SEHK.

Conversely, where there is insufficient demand for shares in the public subscription tranche to take up the initial number of shares allocated to the public subscription tranche, shares may be allocated from the subscription tranche to the placing tranche.

Offer for Sale

For controlling shareholders, an IPO may represent an opportunity to realize some of their holdings in the listed company. The SEHK Listing Rules permit shareholders to offer their shares for sale as part of the IPO but restrict dealings by controlling shareholders both before and after listing.

Marketing

The marketing of the shares to be listed is an important task both to enable compliance with SEHK requirements as to an adequate market for the shares and to raise capital. The marketing of the shares must not only comply with the SEHK Listing Rules and applicable company and securities laws in Hong Kong, but also applicable securities laws in any jurisdiction in which the shares will be sold.

Hong Kong company law and the SEHK Listing Rules prescribe minimum disclosures for a listing document at length and in some detail. These disclosures must include sufficient particulars and information to enable a reasonable person to form a valid and justifiable opinion of the shares to be offered under the IPO and the financial condition and profitability of the company...

Adequate Market

In general terms, the SEHK will not grant a listing unless it is satisfied that there will be sufficient interest in the business of a company and in the securities of the company for which listing is sought.

- *Public Float.* Normally, at least 25 per cent. of a company's total issued share capital must be held by the public (including the retail public and institutional investors). For this purpose, the public float excludes shares held by connected persons (e.g. a director or holder of at least 10 per cent. of the company's voting power) and their proxies. At its discretion, the SEHK may accept a smaller public float of between 15 per cent. to 25 per cent. where the listed company has a market capitalization of over HK\$10 billion.
- *Minimum Number of Shareholders.* The company should, following listing, have an adequate spread of shareholders. Whilst the specific number will vary, in all cases, there must be a minimum of 300 shareholders.
- *Concentration of Shareholders.* In the case of a newly listed company, generally, not more than 50% of the shares in public hands at the time of listing may be beneficially owned by the three largest public shareholders.
- *Minimum Market Capitalization.* The expected market capitalization of a newly listed company, including all securities, listed or not, must be at

least HK\$200 million, with at least HK\$50 million held by the public.

Listing Document

Hong Kong company law and the SEHK Listing Rules prescribe minimum disclosures for a listing document at length and in some detail. These disclosures must include sufficient particulars and information to enable a reasonable person to form a valid and justifiable opinion of the shares to be offered under the IPO and the financial condition and profitability of the company at the time of the issue of the listing document taking into account the nature of the shares offered, the nature of the company and the nature of the persons likely to consider acquiring such shares.

In Hong Kong, both the SEHK and the SFC will review the listing document ahead of the granting of a listing.

Publicity

Hong Kong company and securities laws restrict publicity of a share offer in Hong Kong. In broad terms, any publicity which could amount to an offer or invitation to the public to subscribe for or purchase shares requires prior regulatory approval. However, a company may make a limited statement to raise investor awareness of the offer shortly before the launch of the offer provided that, amongst other things, the statement does not promote the shares under offer.

The SEHK vets all publicity materials relating to a share issuance in an IPO (which excludes materials

Each listing document must include a statement to the effect that the directors, having made all reasonable enquiries, confirm that to the best of their knowledge and belief the information contained in the listing document is accurate and complete in all material respects and not misleading or deceptive and there are no other matters the omission of which would make any statement in the listing document misleading.

promoting the company's products or brand) to ensure that investors acquire shares on the strength of the information in the listing document alone.

Road Shows

Once the SEHK has confirmed that it has no further comments on the listing document and has approved the listing application, the sponsor and the underwriter typically begin a road show to pre-market the shares under the IPO to institutional investors using the listing document (known as a red-herring prospectus) approved by the SEHK.

Profit Forecasts

The SEHK vets profits forecasts, including any statement quantifying or estimating future profits or losses and any valuation of assets (other than land and buildings) based on discounted cash flows or projections of profits, earnings or cash flows. A profit forecast must be clear and unambiguous. It must be presented in an explicit manner and the principal assumptions, including commercial assumptions, upon which it is based, must be stated. These assumptions, so stated, must enable an investor to form a view as to the reasonableness and reliability of the forecast.

Furthermore, a profit forecast must be prepared on a basis that is consistent with the accounting policies normally adopted by the company. The reporting accountants must examine and report on the accounting policies and calculations for the forecast and their report must be set out in the listing document. The

sponsor must be satisfied that the forecast has been made by the directors after due and careful enquiry.

Any pre-IPO research issued by the sponsor, each of the underwriters or their respective associates must not incorporate any profit forecast or other forward looking statements unless such statements are included, in substantially the same form, in the new applicant's listing document.

Liability

The directors of a newly listed company are responsible for the content of the listing document and may bear civil or criminal liability in the event of any misstatement. Each listing document must include a statement to the effect that the directors, having made all reasonable enquiries, confirm that to the best of their knowledge and belief the information contained in the listing document is accurate and complete in all material respects and not misleading or deceptive and there are no other matters the omission of which would make any statement in the listing document misleading.

In light of these liability considerations (as well as the sponsor's desire to discharge its regulatory obligations), the directors will wish to verify that the statements in the listing document are true and complete. In this regard, the sponsor will require a formal, thorough and detailed verification of the statements in the listing document.

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