Relaxation of Listing Requirements on the Stock Exchange of Hong Kong: Exit Opportunities for Private Equity?

The Stock Exchange of Hong Kong ("SEHK") recently announced that companies whose financial situation has been temporarily and adversely affected by the current economic downturn may nevertheless qualify for listing even though they do not strictly meet the minimum profit track record. Whilst relaxation in requirements will be determined on a case-by-case basis, private equity investors may now have the opportunity to exit their investments by way of an IPO on the SEHK despite the negative effects of the financial crisis on their portfolio investments.

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Under the Stock Exchange of Hong Kong ("**SEHK**") listing rules ("**Listing Rules**"), a company applying for listing on the Main Board must satisfy one of the three following basic tests to be eligible for listing:

- the profit test,
- the market capitalization/revenue/cash flow test, or
- the market capitalization/revenue test.

However, under the Listing Rules, the SEHK may waive, modify or not require compliance with the Listing Rules in individual cases.

As a result of the recent global economic downturn, the SEHK has determined that it may relax the profit test where it is satisfied that a fall in the profits of a company applying for listing is linked to the the downturn rather than to the commercial or operational viability and management of the applicant.

Profit Test

Under the existing profit test, a company applying for listing must have an adequate trading record, which means that the company, or its group, must have a trading record of not less than three financial years during which the profit attributable to shareholders must, in respect of the most recent year, be not less than HK$20 million and, in respect of the two preceding years, be in aggregate not less than HK$30 million.

Basis for Relaxation

The SEHK will consider each application on its own merits based on the facts and circumstances of the company applying for listing.

Profit Track Record

Under the relaxed profit test, whilst a company applying for listing need not have profit attributable to shareholders of at least HK$20 million in its most recent financial year:

- it must nevertheless have an aggregate profit attributable to shareholders of at least HK$50 million in respect of the last three financial years immediately preceding the application for listing;
- it should be able to show that, were it not for temporary conditions, its operating profit over those three years would have been significantly in excess of HK$50 million; and
- it should be able to show that the conditions which led to its inability to meet the existing profit test are temporary.

Consistent with the linkage between the relaxation and the economic downturn, the three year track record period must include at least one financial year that ended on or after 31 December 2008.

Disclosures

A company applying for a relaxation will need to describe to the SEHK the measures that it has taken or will take to mitigate the impact of the temporary conditions on future profits. In like vein, the listing document must adequately disclose the likelihood of continuance or recurrence of these conditions.

Cashflow & Working Capital

Although the existing profit test does not require a company applying for listing to meet any minimum cash flow or working capital requirements, to qualify for the relaxation:

- a company must have positive cashflow generated from operating activities in the ordinary and usual course of business before changes in working capital and taxes paid in the last financial year during the track record period; and
- a company must demonstrate that it will have adequate working capital for 12 months' operation after listing.

Conclusion

A relaxation in the existing profit test is welcome news for investors of privately held companies who may wish to exit their investments through a listing of those companies. Whilst the changes do not open the door for troubled companies to list, they do lower the regulatory thresholds for strong and viable companies to list in a challenging stage of the economic cycle. ■

TIMOTHY LOH, SOLICITORS serves as Hong Kong and international legal counsel to financial institutions. Since its establishment in 2004, its clients have included 10 financial institutions ranked in the FT Global 200. It is ranked by the International Financial Law Review 1000 as a leading practice in Hong Kong banking law, the only non-global law firm to achieve this ranking, and it has been recommended each year by the Asia Pacific Legal 500 for its financial services and regulatory practice.

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