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Hong Kong Proposes Reform to Listing Regime for Specialist Technology Companies

Market capitalisation, research and development investment, and historical financing would be the primary bases for listing such companies under the new proposal.

On 19 October 2022, The Stock Exchange of Hong Kong Limited (the SEHK) issued a [consultation paper](#) (the Consultation Paper) on the listing regime for specialist technology companies proposing to include a new Chapter 18C within the Rules Governing the Listing of Securities on the SEHK (the Listing Rules). The SEHK is inviting public comments on the proposals until the end of the consultation period on 18 December 2022. This reform proposal has been long-awaited after the 2018 Listing Reform, which permitted the listing of qualifying pre-profit biotech companies and innovative companies with weighted voting rights (WVR) structures, and also created a secondary listing route for overseas issuers listed on qualifying exchanges. These proposals, once adopted, would further diversify Hong Kong's capital market with broader opportunities for investors.

This Client Alert discusses the main proposals within the consultation paper and compares the proposed listing regime against existing rules and requirements.

What Is a Specialist Technology Company?

The SEHK intends to define a "Specialist Technology Company" as "primarily engaged in the research and development of, and the commercialisation and/or sales of, 'Specialist Technology Products' within an acceptable sector of a 'Specialist Technology Industry'".

Specialist Technology Industries and Acceptable Sectors

The proposed new regime initially will include the following industries as "Specialist Technology Industries", which the SEHK will update through guidance letters from time to time:

Specialist Technology Industries	Acceptable Sectors
1) Next-generation information technology	<ul style="list-style-type: none"> • Cloud-based services • Artificial intelligence
2) Advanced hardware	<ul style="list-style-type: none"> • Robotics and automation • Semiconductors • Advanced communication technology • Electric and autonomous vehicles • Advanced transportation technology • Aerospace technology • Advanced manufacturing • Quantum computing • Metaverse technology
3) Advanced materials	<ul style="list-style-type: none"> • Synthetic biological materials • Smart glass • Nanomaterials
4) New energy and environmental protection	<ul style="list-style-type: none"> • New energy generation • New energy storage and transmission technology • New green technology
5) New food and agriculture technologies	<ul style="list-style-type: none"> • New food technology • New agriculture technology

The SEHK may update the guidance on the Specialist Technology Industries and acceptable sectors from time to time, taking into account the following principles:

- (a) Participants in the relevant sector must have high growth potential.
- (b) The success of participants in the sector can be demonstrated to be attributable to the application to their core business of new technologies and/or the application of the relevant science and/or technology within that sector to a new business model, which also serves to differentiate them from traditional market participants serving similar consumers or end-users.
- (c) Research and development significantly contributes to the expected value and constitutes a major activity and expense of participants in the sector.

The listing applicants need not possess “leading-edge” technologies. However, the SEHK reserves a right to reject an application for listing if it displays attributes inconsistent with the aforementioned principles. The SEHK will consider all relevant facts when evaluating whether the listing applicant is suitable for listing.

Definition of “Primarily Engaged”

The SEHK proposes that if a company has multiple business segments, some of which do not fall within any Specialist Technology Industries, the SEHK will take into account certain factors to determine whether the company is “primarily engaged” in the relevant business (as referred to in the definition of a Specialist Technology Company). These factors include whether:

- (a) a substantial portion of the company's total operating expenditure and senior management resources (including their time and number of directors and senior management personnel with relevant expertise and experience) was dedicated to the research and development of, and the commercialisation and/or sales of, Specialist Technology Product(s) in the company's specialist technology business segment(s) for at least three financial years prior to listing;
- (b) investors' valuation and the expected market capitalisation of the company is based primarily on the company's specialist technology business segment(s), rather than its other unrelated business segments or assets; and
- (c) the proposed use of proceeds would primarily be applied to its specialist technology business segment.

Comparison of Listing Requirements

Compared with the current listing requirements of Chapter 8 of the Listing Rules, the proposed Chapter 18C establishes two thresholds: (1) "Commercial Companies" that have achieved meaningful commercialisation; and (2) "Pre-commercial Companies". Both have relaxed the requirements for income and profitability, and adopt market capitalisation, R&D investment, and historical financing as alternative listing requirements. The following table summarises the current Chapter 8 and proposed Chapter 18C listing requirements:

	Chapter 8 Listing Requirements			Proposed Chapter 18C Listing Requirements	
	Profit Test LR 8.05(1)	Market Capitalisation/ Revenue/ Cashflow Test LR 8.05(2)	Market Capitalisation/ Revenue Test LR 8.05(3)	Commercial Companies	Pre-commercial Companies
Profit	<u>HK\$35 million</u> for the most recent financial year; <u>HK\$45 million</u> for the previous two years	N/A	N/A	N/A	N/A
Minimum market capitalisation upon listing	<u>HK\$500 million</u>	<u>HK\$2 billion</u>	<u>HK\$4 billion</u>	<u>HK\$8 billion</u>	<u>HK\$15 billion</u>

	Chapter 8 Listing Requirements			Proposed Chapter 18C Listing Requirements	
	Profit Test LR 8.05(1)	Market Capitalisation/ Revenue/ Cashflow Test LR 8.05(2)	Market Capitalisation/ Revenue Test LR 8.05(3)	Commercial Companies	Pre-commercial Companies
Revenue	N/A	<u>HK\$500 million</u> for the most recent audited financial year	<u>HK\$500 million</u> for the most recent audited financial year	<u>HK\$250 million</u> arising from the specialist technology business segment(s) for the most recent audited financial year	N/A
Cashflow	N/A	Accumulated net cash flow of not less than <u>HK\$100 million</u> in the last three years	N/A	N/A	N/A
Research and development period and minimum investment amount	N/A	N/A	N/A	Engaged in R&D for at least three financial years prior to listing Total R&D investment as a percentage of total operating expenditure for each of the three financial years prior to listing should be no less than <u>15%</u>	Engaged in R&D for at least three financial years prior to listing Total R&D investment as a percentage of total operating expenditure for each of the three financial years prior to listing should be no less than <u>50%</u>

	Chapter 8 Listing Requirements			Proposed Chapter 18C Listing Requirements	
	Profit Test LR 8.05(1)	Market Capitalisation/ Revenue/ Cashflow Test LR 8.05(2)	Market Capitalisation/ Revenue Test LR 8.05(3)	Commercial Companies	Pre-commercial Companies
Third-party investment	N/A	N/A	N/A	Third-party investment from at least two Pathfinder Sophisticated Independent Investors who have invested at least 12 months before the date of the listing application, each holding such amount of shares or securities convertible into shares equivalent to 5% or more of the issued share capital of the listing applicant as at the date of the listing application and throughout the pre-application 12-month period (Please refer to the section titled "Pathfinder Sophisticated Independent Investors" below)	
Additional requirements for working capital	N/A	N/A	N/A	N/A	Available working capital to cover at least <u>125%</u> of its group's costs for at least the next 12 months (after taking into account the IPO proceeds)
Operational track record and management continuity	In operation in its current line of business for at least three financial years prior to listing under substantially the same management				
Ownership continuity	Ownership continuity and control for the most recent audited financial year			Ownership continuity and control in the 12 months prior to the date of the listing application	

Pathfinder Sophisticated Independent Investors

The SEHK now proposes the following requirements for third-party investment for both "Commercial Companies" and "Pre-commercial Companies":

- Investment from at least two “Pathfinder Sophisticated Independent Investors” at least 12 months prior to the date of the listing application, with each holding such amount of shares or securities convertible into shares equivalent to 5% or more of the issued share capital of the listing applicant as at the date of listing application and throughout the pre-application 12-month period;

The SEHK proposes that the “Sophisticated Independent Investor” must not be a core connected person of the listing applicant (except a person connected only by virtue of being a substantial shareholder), and should be recognised by the SEHK as a “sophisticated investor”. The SEHK now intends to consider the following as examples of sophisticated investors:

- An asset management firm with AUM of, or a fund with a size of, at least HK\$15 billion
 - A company with a diverse investment portfolio size of at least HK\$15 billion
 - An investor of any of the types above with an AUM, fund size, or investment portfolio size (as applicable) of at least HK\$5 billion, with that value derived primarily from specialist technology investments
 - A key participant in the relevant upstream or downstream industry with substantial market share and size, as supported by appropriate independent market or operational data
- The investment from all Sophisticated Independent Investors should result in their holding, in aggregate, such amount of shares or securities convertible into shares equivalent to at least the percentage of the issued share capital of the applicant at the time of listing as set out below:

Expected market capitalisation at the time of listing	Minimum total investment from all Sophisticated Independent Investors (including subscription amount for IPO) (as a percentage of the issued share capital at the time of listing, including those issued in IPO)	
	Commercial Companies	Pre-commercial Companies
Between the minimum threshold and HK\$20 billion	20%	25%
Between HK\$20 billion and HK\$40 billion	15%	20%
HK\$40 billion or more	10%	15%

Comparison With Secondary Listing Under 19C

If a company already listed elsewhere intends to conduct a dual listing in Hong Kong (through a primary or secondary listing), but is yet to satisfy the listing record or timing requirements on a qualifying exchange under Chapter 19C or the conventional listing requirements under Chapter 8 of the Listing Rules, the proposed Chapter 18C would provide two additional channels for companies to consider the feasibility of dual listing. However, if a dual listing is carried out through Chapter 18C, the company will be primarily listed in Hong Kong and will therefore need to comply with the listing requirements of the original

listing place and Hong Kong at the same time, and may not be able to enjoy various waivers under Chapter 19C.

Specialist Technology Company With WVR

If a Specialist Technology Company wishes to apply for a WVR structure, similar to other companies, it should satisfy the requirements under Chapter 8A. The SEHK has not imposed any additional requirements or removed any of the existing requirements.

Given that the revenue of a Specialist Technology Company may only range from HK\$ 250 million to 500 million, falling short of the HK\$ 1 billion threshold under Rule 8A.06 of the Listing Rules, the relevant listing applicant may need to reach the HK\$ 40 billion threshold of market capitalisation to establish a WVR structure.

Proposed Disclosure Requirements

In order to facilitate investors' evaluation of Specialist Technology Companies, the SEHK proposes the following disclosure requirements: pre-IPO investments, cash flow-related disclosures, products and commercialisation status and prospects, R&D, industry specific information, and intellectual property.

Separately, a Commercial Company would be required to put a prominent warning statement on the cover of its listing document that it is a Specialist Technology Company and so investment in its securities carries additional risks. For a Pre-commercial Company, the warning statement shall, in addition to the above, draw investors' attention to the risk that it may not successfully commercialise to generate sufficient revenue to sustain its operations after listing and the heightened risk that it may fail due to a lack of available funds.

In addition to the above, a Pre-commercial Company must make the following disclosures in its listing document:

- (a) The stage of research and development for each of its Specialist Technology Product(s)
- (b) Development details by key stages and milestones for its Specialist Technology Product(s) to achieve the commercialisation revenue threshold
- (c) All relevant risks associated with the commercialisation of each of its Specialist Technology Product(s).

Proposed Requirements for Offering and Post-Listing Compliance

The table below summarises the SEHK's requirements in relation to the offering and relevant post-listing compliance:

Initial allocation and clawback mechanism	In the initial allocation, the minimum proportion of the total number of shares allocated to retail investors has been reduced from 10% to 5%; when over-subscribed, the clawback proportion is also less than the current requirements. After clawback, a maximum of 20% of the total shares will be allocated to retail investors.
Minimum ratio of institutional investors	Before any over-allotment option, at least 50% of the placing must be taken up by independent institutional professional investors in the placing tranche (whether as cornerstone investors or otherwise, but excluding any existing shareholders, their respective close associates, or any core connected persons).
Free float	<p>Free float, i.e., absence of any disposal restrictions, is a new requirement under Chapter 18C. The minimum Free float requirement is HK\$600 million upon listing.</p> <p>Note: Free float and public float are two distinct concepts. SEHK's requirements on public float have not been tightened or relaxed, and listing applicants should comply with both at the same time.</p>
Offer size	The size of the offering has to be meaningful. If the offer size is not significant enough to facilitate post-listing liquidity, or may otherwise give rise to orderly market concerns, the SEHK reserves the right not to approve the listing of a Specialist Technology Company
Lock-up requirements	<p><u>Controlling Shareholders:</u></p> <ul style="list-style-type: none"> • 12 months (Commercial Company) • 24 months (Pre-commercial Company) <p><u>Key Persons (including founders, WVR beneficiaries, executive directors and senior management, and key personnel responsible for technology or R&D):</u></p> <ul style="list-style-type: none"> • 12 months (Commercial Company) • 24 months (Pre-commercial Company) <p><u>Pathfinder Sophisticated Independent Investors:</u></p> <ul style="list-style-type: none"> • Six months (Commercial Company) • 12 months (Pre-commercial Company)
Post-listing compliance	<p><u>Commercial Companies:</u></p> <ul style="list-style-type: none"> • Same as other primary-listed companies, no additional requirements <p><u>Pre-Commercial Companies:</u></p> <ul style="list-style-type: none"> • Stock marker: unique stock marker "PC" at the end of their stock names • Additional disclosure in interim and annual reports: details of their R&D activities and commercialisation progress <ul style="list-style-type: none"> – details of the development progress of their Specialist Technology Product(s) under development – the timeframe for and any progress made towards achieving the commercialisation revenue threshold – update on any financial and operating data disclosure in the listing document – a summary of their R&D investment during the relevant period

- warning statement

- Sufficient operations or delisting: if the SEHK considers that a Pre-commercial Company has failed to meet its continuing obligation to maintain sufficient operations or assets, the SEHK may give the issuer a period of up to 12 months to re-comply with the requirement. If the issuer fails to do so, the SEHK will cancel its listing.
- No material change of business: a Pre-commercial Company must not effect any transaction that will result in a fundamental change to its principal business without the prior consent of the SEHK.

The SEHK's consultation period will end on 18 December 2022. Latham & Watkins will closely monitor any updates to the listing regime for Specialist Technology Companies.

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