



SFC Regulatory Bulletin: Listed Corporations

Foreword

This third edition of the *SFC Regulatory Bulletin: Listed Corporations* provides guidance on how the SFC utilises its investigative powers under the Securities and Futures Ordinance (SFO) and the statutory powers to object to a listing or impose a suspension of trading of securities under the Securities and Futures (Stock Market Listing) Rules (SMLR) to deliver front-loaded regulation over listed companies and listing applicants.

The SFC's front-loaded approach does not replace its enforcement actions. The fact that a listing application or other corporate transaction has lapsed or been withdrawn does not preclude the SFC from taking enforcement action where appropriate.

The SFC will directly intervene at an early stage in suspected cases of serious misconduct that would fall within the scope of the SMLR or the SFO more generally to prevent harm to investors and to protect our markets. Examples include proposed transactions that appear to the SFC to (i) be oppressive or unfairly prejudicial to the shareholders or potential investors of a listed company, (ii) involve fraud or other serious misconduct towards a listed

company or its shareholders or potential investors, or (iii) result in the shareholders or potential investors of a listed company not having been given all the information with respect to its business or affairs that they might reasonably expect.

Directors are reminded that they must act in good faith in the interests of the company and exercise due and reasonable care, skill and diligence when evaluating, proposing or approving corporate transactions. Moreover, directors have a duty to exercise their own judgement regarding a proposed transaction and should not rely on third party opinions or advice to an unreasonable extent. Please refer to the [guidance note](#) on directors' duties, [circular](#) to financial advisers regarding valuations in corporate transactions and [statement](#) on the liability of valuers for disclosure of false or misleading information issued in May 2017.

Case studies

To help the public better understand the SFC's approach to performing its functions under section 6 and section 8 of the SMLR, the following case studies outline some of the SFC's recent actions.

IPO cases

IPO case 1

The applicant, a retailer, diversified into wholesaling during the track record period and submitted that its revenue rose significantly in the most recent year due to its marketing efforts and sales to a wholesaler which on-sold its products to a leading e-commerce platform.

The SFC noted that the applicant only launched its marketing activities towards the end of the track record period, the amount of such marketing activities was insignificant and the sales of its products on the relevant e-commerce platform appeared to be minimal. The SFC had concerns about the accuracy of the applicant's financial information and whether it presented a true and fair view of its business performance.

The SFC wrote to the applicant asking for further information to explain and substantiate its significant revenue growth. The applicant was unable to provide satisfactory explanations and ultimately withdrew its listing application.

IPO case 2

During the track record period, the listing applicant, which was engaged in the transport business, chartered a majority of its vehicles to a third party which was not licensed to operate them. The third party in turn instructed the applicant to operate the vehicles. Such an operating arrangement appeared to contravene the conditions of the applicant's vehicle operating licence. The SFC wrote to the applicant expressing concerns and requesting an explanation.

The SFC was also concerned whether the historical financial information included in the listing application was representative of the applicant's business model going forward given that the operating arrangement was terminated shortly after the end of the track record period. The applicant allowed the application to lapse without addressing the SFC's concerns.

Post-IPO cases

Post-IPO case 1

The company proposed to acquire a target company, which was mainly engaged in research and development for the use of artificial intelligence and big data technology in securities services, by issuing new shares at a premium of 79% to the latest closing price. According to the company's announcement, the target did not record any revenue and was loss-making in the most recent financial year.

The SFC commenced section 179 inquiries (see sidebar on page 3) which revealed that the target's largest shareholder was a relative of the company's chairman. In addition, the company had not sought any independent financial advice or an independent valuation.

The SFC was concerned whether the proposed acquisition was fair and reasonable and unfairly prejudiced the interests of the company's shareholders. Accordingly, the SFC issued a letter of concern to the company requesting an explanation. The company did not address the SFC's concerns and the acquisition lapsed.

Post-IPO case 2

The company proposed to acquire a 65% interest in a loss-making target company which was developing robotics. The vendor gave a profit guarantee to the target company for the 12 months after completion of the transaction. Were there to be a shortfall in the guaranteed profit, part of the consideration would be returned to the company.

The SFC commenced section 179 inquiries and found material issues with the draft valuation report on the target as well as its cash flow forecast report. The company was unable to provide a reasonable explanation for the basis and assumptions used to determine the target's projected revenue, profit margin and valuation. Also, the target had not commenced operations for its core business as of the date of the announcement.

In light of the above, the SFC issued a letter of concern to the company requesting an explanation. The company did not address the SFC's concerns and the acquisition lapsed.

Post-IPO case 3

The company proposed to acquire a 7.5% interest in a loss-making target with net liabilities, which was engaged in the audio technology business. The SFC commenced section 179 inquiries requesting details. In the course of its inquiries, the SFC noted that the company had not sought independent financial advice or an independent valuation of the target. The company was also unable or reluctant to provide evidence that the deposit for the acquisition had in fact been paid to the vendor.

This called into question the authenticity of the acquisition and the identity of the actual vendor. As a result, the SFC issued a letter of concern to the company requesting an explanation. The company did not address the SFC's concerns and the acquisition did not proceed.

Post-IPO case 4

A listed company proposed to acquire an 80% interest in a target company engaged in financial leasing through the issue of consideration shares. The target had been incorporated one year earlier. It appeared that the only business conducted by the target since its incorporation was to enter into financial lease agreements with its vendor. The target recorded minimal revenue in the latest financial period, and it appeared that the target may not have had any customers who were independent of the vendor.

Commencing section 179 inquiries, the SFC raised concerns that the proposed transaction might be unfairly prejudicial to the interests of shareholders given the target's minimal track record and minimal client base. The SFC requested the company to explain why, given low entry barriers in the financial leasing market, it chose to enter this business by acquiring the target instead of directly soliciting or winning business organically. The company did not address the SFC's concerns and subsequently announced the termination of the transaction.

Section 179 (1) of the SFO provides that the SFC may require the production of any books and records where it appears to the SFC that there are circumstances suggesting:

- (a) the business of the corporation has been conducted (i) to defraud creditors, (ii) for any fraudulent or unlawful purpose; or (iii) in a manner oppressive to its shareholders;
- (b) the corporation was formed for any fraudulent or unlawful purpose;
- (c) persons involved in the corporation's listing have engaged, in relation to such process, in defalcation, fraud, misfeasance or other misconduct;
- (d) persons who managed the corporation have engaged in defalcation, fraud, misfeasance or other misconduct towards it or its shareholders; or
- (e) shareholders of the corporation have not been given all the information with respect to its affairs that they might reasonably expect.

Post-IPO case 5

The company proposed to acquire, mainly through the issue of convertible notes, a company engaged in the construction and operation of natural gas pipelines and networks. The target was loss-making for 2016 and 2017. The unaudited net asset value of the target comprised mostly intangible assets and the company disclosed that the target had not yet commenced any significant business operations.

The SFC was concerned that the proposed transaction may be unfairly prejudicial to the interests of the company's shareholders given the target's losses, operating risks, minimal tangible assets and lack of a track record.

As such, the SFC commenced section 179 inquiries questioning the company's rationale for the proposed acquisition. The company failed to address the SFC's concerns in its submissions and subsequently announced the termination of the transaction.

Post-IPO case 6

The company proposed to raise funds through a general mandate placing. The placing price was set at a significant discount of 80% to its net asset value per share. As at the date of the company's latest interim financial results, it appeared to have sufficient cash to fund its operations and minimal total borrowing.

The SFC raised concerns about why the placing was being conducted at such a substantial discount when the company did not appear to have an imminent need to raise funds. The company subsequently terminated the placing.

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