KPMG

Hong Kong Capital Markets Update

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HKEX's consultation on listing of Specialist Technology Companies

Key Proposals

"Specialist Technology" – Broad definition including the following industries:

(a) Next-generation information technology	**(b) Advanced hardware**	**(c) Advanced materials**
(d) New energy and environmental protection	**(e) New food and agriculture technology**	

Key listing requirements for Commercial and Pre-Commercial Companies

	Commercial Companies	Pre-Commercial Companies
Expected Market Capitalisation	At least **HK$8 billion** at the time of listing	At least **HK$15 billion** at the time of listing
Revenue	At least **HK$250 million**[1] for the most recent audited financial year	No requirement
Research and Development ("R&D")	Engaged in **R&D** for **at least three financial years**	
	For **EACH** of **last three financial years**: $\frac{\textbf{R\&D investment}}{\textbf{Operating expenditure}} \geq \textbf{15\%}$	For **EACH** of **last three financial years**: $\frac{\textbf{R\&D investment}}{\textbf{Operating expenditure}} \geq \textbf{50\%}$
Operational Track Record	At least **three financial years** of operation under **substantially the same management** prior to listing	
Ownership Continuity	At least **12 months** prior to the date of the listing application	
Working Capital Requirement	At least **100%** of group's requirement for next 12 months	At least **125%** of group's costs for next 12 months

Meaningful investment from Sophisticated Independent Investors

- **Indicative benchmark** of **meaningful investment** from **sophisticated independent investors** ("**SIIs**"):
  - (a) **at least two "Pathfinder" SIIs** at least **12 months before** the **listing application date**, **each holding** shares or securities convertible into shares equivalent to **at least 5%** of issued **share capital** of the listing applicant **at the listing application date** and **throughout the pre-application 12-month period**; and
  - (b) the **minimum total investment** from **all SIIs** (as a percentage of issued share capital) **at** the time of **listing**:

Expected Market Capitalisation	Commercial Companies	Pre-Commercial Companies
< HK$20B	20%	25%
HK$20B to HK$40B	15%	20%
≥ HK$40B	10%	15%

Post-IPO lock-up period

	Disposal restriction	Commercial Companies	Pre-Commercial Companies
Controlling shareholders ("CSs") & Key Persons[2]	**Securities beneficially owned** as disclosed in listing document (excluding those sold under any offer for sale contained in the listing document)	**12 months** from listing date	**24 months** from listing date
Pathfinder SIIs		**6 months** from listing date	**12 months** from listing date

[1] Only revenue from Specialist Technology business segments (excluding inter-segmental revenue) will be counted towards the HK$250 million requirement.

[2] Include founders, WVR beneficiaries, executive directors, senior management and key personnel for technical operations/R&D of Specialist Technology product/service.

Background

On 19 October 2022, the Stock Exchange of Hong Kong Limited ("Exchange") published a consultation paper ("Consultation") seeking market feedback on proposals to enable the listing of Specialist Technology Companies[3] on the main board of the Exchange ("Main Board"). The deadline for submissions is 18 December 2022.

Despite the improved market diversification following the listing reforms in 2018, Hong Kong still lags behind the United States and Mainland China in terms of listing of Specialist Technology Companies. This is because these companies often face difficulties to meet the Main Board financial eligibility requirements for listing in Hong Kong.

Many of these Specialist Technology Companies are still primarily engaged in R&D to bring their products and/or services to commercialisation (i.e. "Pre-Commercial Companies"), and even for those that have achieved "meaningful commercialisation" of their products and/or services (i.e. "Commercial Companies") they are also unable to meet the Main Board profit, revenue or cash flow requirements because of the nature of their businesses, in spite of the fact that some of these companies' market capitalisation may be well over the minimum threshold for a Hong Kong listing.

While there would be strong appetite among investors in Hong Kong for the listings of Specialist Technology Companies due to their high growth potential, there are also certain regulatory issues over their listings such as (a) difficulty in reaching a consensus on valuation; (b) absence of a competent authority (i.e. an independent external body with relevant expertise or experience); (c) viability of a product or service; (d) failure to successfully commercialise; and (e) reliance on external funding to support operations.

To facilitate the listing of Specialist Technology Companies on the Main Board, the Exchange has set out the proposals in the Consultation to address the above issues. The key proposals are summarised below.

"Specialist Technology" – Broad definition

Due to the ever-evolving nature of technology, it is difficult to have an exhaustive definition of "Specialist Technology" that is constantly up-to-date and to accurately identify the types of companies with strong growth potential.

Therefore, the Exchange is proposing to implement a broad definition for "Specialist Technology" in the Listing Rules[4] and supplemented by a guidance letter on the acceptable industries and sectors that would fall within that definition. This will provide flexibility for the Exchange to update the scope of Specialist Technology Industries from time to time to include newly emerging industries and the latest technology trends as necessary.

In the Consultation, the Exchange proposes five Specialist Technology Industries based on the eligible industries for STAR Market[5] and suggests the acceptable sectors which fall within "Specialist Technology Industries" as follows:

<table>
<tr><th>Specialist Technology Industry</th><th colspan="2">Acceptable sectors in each Specialist Technology Industry</th></tr>
<tr><td>(a) Next-generation information technology</td><td>- Cloud-based services</td><td>- Artificial intelligence</td></tr>
<tr><td rowspan="5">(b) Advanced hardware</td><td>- Robotics and automation</td><td>- Aerospace technology</td></tr>
<tr><td>- Semiconductors</td><td>- Advanced manufacturing</td></tr>
<tr><td>- Electric and autonomous vehicles</td><td>- Advanced communication technology</td></tr>
<tr><td>- Quantum computing</td><td>- Metaverse technology</td></tr>
<tr><td colspan="2">- Advanced transportation technology</td></tr>
<tr><td rowspan="2">(c) Advanced materials</td><td>- Synthetic biological materials</td><td>- Nanomaterials</td></tr>
<tr><td colspan="2">- Smart glass</td></tr>
<tr><td rowspan="2">(d) New energy and environmental protection</td><td>- New energy generation</td><td>- New green technology</td></tr>
<tr><td colspan="2">- New energy storage and transmission technology</td></tr>
<tr><td>(e) New food and agriculture technologies</td><td>- New food technology</td><td>- New agriculture technology</td></tr>
</table>

However, a biotech company relying on a regulated product (as defined in Listing Rules Chapter 18A) as the basis of its listing application must submit the application under Listing Rules Chapter 18A and not this proposed regime.

[3] Specialist Technology Company is a company primarily engaged (directly or through its subsidiaries) in the R&D of, and the commercialisation and/or sales of, a product and/or service that applies science and/or technology within an acceptable sector of one or more Specialist Technology Industries.

[4] The Rules Governing the Listing of Securities on the Exchange

[5] There are six eligible industries for the STAR Market of Shanghai Stock Exchange, which are (a) next-generation information technology; (b) high-end equipment; (c) new materials; (d) new energy; (e) environmental protection; and (f) bio-pharmaceuticals.

“Commercial Companies” and “Pre-Commercial Companies”

Because of the additional risks associated with Pre-Commercial Companies (e.g. the risk of failure to successfully commercialise, higher risk of corporate failure due to a lack of funding, etc), the Exchange proposes to apply, as compared to Commercial Companies, more stringent requirements to Pre-Commercial Companies, including:

- a larger minimum market capitalisation at listing;
- higher third party investment thresholds to support their valuation;
- demonstration of a credible path to achieving the Commercialisation Revenue Threshold (see below);
- longer post-IPO lock-up period for certain shareholders; and
- additional disclosure requirements (both in the listing document and on an ongoing basis).

To distinguish Pre-Commercial Companies from Commercial Companies, the Commercialisation Revenue Threshold (see below) is proposed as a “bright line” test to demonstrate that “meaningful commercialisation” has been achieved.

A comparison of the key listing requirements for Commercial and Pre-Commercial Companies is set out on page 1.

Qualifications for listing of Specialist Technology Companies

Commercialisation Revenue Threshold

The Exchange proposes Commercial Companies must have revenue of at least HK$250 million for the most recent audited financial year (“Commercialisation Revenue Threshold”). Such proposed threshold is close to the revenue threshold of RMB200 million to RMB300 million imposed by the STAR Market.

For the purpose of this requirement, only revenue attributable to the Specialist Technology business segment(s) (excluding any inter-segmental revenue to other business segments of the listing applicant) would be recognised and not those revenue and gains that arise incidentally or from other businesses (such as rental income from property investment).

Also, Commercial Companies are normally expected to demonstrate year-on-year growth of revenue arising from the Specialist Technology business segment throughout the track record period, with allowance for temporary declines in revenue due to economic, market or industry-wide conditions. Any downward trend in the Commercial Company’s annual revenue during the period must be explained and properly addressed.

Minimum expected market capitalisation

The Exchange suggests Commercial Companies and Pre-Commercial Companies must demonstrate a minimum expected market capitalisation at listing of HK$8 billion and HK$15 million, respectively.

The market capitalisation threshold for Commercial Companies has been set with reference to the level at which they would be considered as “unicorns” within the investment industry (i.e, with a valuation of over US$1 billion), while the market capitalisation threshold for Pre-Commercial Companies has been proposed as almost double of that for Commercial Companies.

Minimum R&D period and investment

Given R&D investment is considered as an essential component of a Specialist Technology Company, the Exchange is proposing that a Specialist Technology Company should have been engaged in R&D of its product and/or service that applies Specialist Technology for a minimum period of three financial years prior to listing.

Also, the Exchange suggests a minimum annual R&D investment, as a percentage of total annual operating expenditure (“R&D ratio”), of 15% for Commercial Companies and 50% for Pre-Commercial Companies for each of the three financial years prior to listing. For the purpose of R&D ratio calculation, the amounts of qualifying R&D investment and total operating expenditure are:

Qualifying R&D investment (i.e. costs that are directly attributable to company’s R&D activities)
- include R&D costs that have been recognised as expenses in the financial statements during the period; - include development costs for the period that have been capitalised as intangible assets for accounting purposes; - exclude general, administrative and other costs that are not clearly related to R&D activities; and - exclude initial recognition of fixed assets relating to R&D (e.g. capital expenditures for acquiring a R&D centre).

Total operating expenditure
- include the sum of the company’s total expenses as reflected in the financial statements during the period; - include costs that have not been recognised as expenses but qualified as R&D investment during the period; and - exclude any expenses of a financial nature.

Minimum operational track record and ownership continuity

The Exchange proposes the listing applicant under this proposed regime should have been in operation in its current line of business for at least three financial years prior to listing under substantially the same management[6] and must have the ownership continuity and control in the 12 months prior to the date of the listing application. Both of these proposals are consistent with the existing Main Board listing requirements.

Working capital requirement

To reduce the risk of a Pre-Commercial Company being unable to meet its operational expenses after listing without the support of revenue and/or profits, the Exchange is proposing to require the Pre-Commercial Company listing applicant to have working capital to cover at least 125% of the group's costs for at least the next 12 months (after taking into account the IPO proceeds of the listing applicant). These costs must substantially consist of (a) general, administrative and operating costs; and (b) R&D costs.

Meaningful investment from sophisticated independent investors

To address concerns over the difficulty in valuing Specialist Technology Companies, the Exchange suggests the listing applicant under the proposed regime must have received meaningful investment from sophisticated independent investors.

Independence requirement

The Exchange proposes a sophisticated investor must not be a core connected person of the listing applicant (e.g. the controlling shareholder) for independence purpose. Nevertheless, a substantial shareholder of the listing applicant who is a core connected person only because of the size of its shareholding in the listing applicant, or the existence of a prior business relationship, would not result in a failure to meet the independence requirement.

Definition of sophisticated investor

The Exchange will assess whether an investor is a "sophisticated investor" on a case-by-case basis with reference to its relevant investment experience, knowledge and expertise in the relevant field.

Examples of "sophisticated investors"	
(i)	an asset management firm with assts under management ("AUM") of, or a fund with a fund size of, at least HK$15 billion;
(ii)	a company having a diverse investment portfolio size of at least HK$15 billion;
(iii)	an investor of (i) or (ii) above with an AUM, fund size or investment portfolio size (as applicable) of at least HK$5 billion where that value is derived primarily from Specialist Technology investments; and
(iv)	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.

Minimum investment requirement

The Exchange has set out an indicative benchmark in which a listing applicant will generally be considered as having meaningful investment from sophisticated independent investors. This indicative benchmark includes the individual shareholding requirement and the minimum aggregate investment requirement.

For the minimum aggregate investment requirement, it is proposed that both the investments by sophisticated independent investors made before the listing and any offer shares issued to them in the IPO will be counted.

To mitigate the additional risks associated with Pre-Commercial Companies, a higher minimum aggregate investment threshold for Pre-Commercial Companies has been proposed. The indicative thresholds for Commercial and Pre-Commercial Companies are set out on page 1.

[6] The Exchange may accept a shorter trading record of at least two financial years in exceptional circumstances.

Post-IPO lock-up period

Controlling shareholders

To give more assurance that the controlling shareholders are committed to the long-term development of the Specialist Technology Company, the Exchange proposes the controlling shareholders of a Specialist Technology Company should be subject to a more stringent lock-up period than that for the current Main Board issuers[7].

Key Persons[2]

Given the Key Persons of a Specialist Technology Company should have made material contributions in the past and will continue to contribute after listing, the Exchange proposes that Key Persons and their close associates should be subject to a restriction on the disposal of their holdings in the Specialist Technology Company following its listing.

Pathfinder SIIs

To help ensure the faith that the Pathfinder SIIs have previously demonstrated in the listing applicant's prospects prior to listing, on which public investors may have place reliance, would continue to be demonstrated for a period after listing, the Exchange proposes the Pathfinder SIIs should be subject to a restriction on the disposal of their holdings in the Specialist Technology Company following its listing.

Length of lock-up period

Due to the additional risks associated with early-stage Pre-Commercial Companies, it is suggested that the lock-up period of Pre-Commercial Companies should be longer than that of Commercial Companies. The post-IPO lock-up requirements for Commercial and Pre-Commercial Companies are set out on page 1.

Securities subject to lock-up

The Exchange proposes that only the securities beneficially owned by controlling shareholders, Key Persons and Pathfinder SIIs as disclosed in listing document would be subject to lock-ups. They would not be restricted from disposing their shares prior to listing or offering them for sale as part of the IPO (i.e. only the shares retained by them after listing would be subject to the lock-up restrictions). In addition, these shareholders subject to a lock-up would generally be allowed to dispose of their additional shares purchased in the IPO during the lock-up period[8].

Other requirements

Minimum free float and meaningful offer size

To mitigate market manipulation and price volatility concerns, the Exchange proposes the listing applicant applying to list under this proposed regime must ensure a minimum free float (being shares not subject to any disposal restrictions) of at least HK$600 million upon listing. Also, the Exchange expects the listing of a Specialist Technology Company to be accompanied by an offer of a meaningful size and reserves the right not to approve the listing if the offer size is not significant enough to facilitate post-listing liquidity, or otherwise gives rise to orderly market concerns.

Specific disclosure requirements

To facilitate IPO investors' assessment, the Exchange proposes the Specialist Technology Company must include specific disclosures in its listing document with respect to (a) pre-IPO investments and cash flows; (b) products and commercialisation status and prospects; (c) R&D; (d) industry specific information; and (e) intellectual property. Also, it is required to include a warning statement in the listing document to draw investors' attention that the listing applicant is a Specialist Technology Company and hence investment in its securities carries additional risks.

For a Pre-Commercial Company, it is additionally required to disclose in the listing document the key stages and milestones for its Specialist Technology products and/or services to achieve the Commercialisation Revenue Threshold, and the warning statement should also draw investors' attention to the risk that the company may not generate sufficient revenue to sustain its operations after listing and that it may fail due to a lack of available funds.

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[7] Current lock-up period for the CSs of Main Board issuers: (i) disposal of securities is not allowed for a six months period from the listing date; and (ii) disposal of securities that would result in the CS ceased to be a CS is not allowed for a six months period following the end of the period referred in (i).

[8] If such shareholder subscribes shares in the IPO as a cornerstone investor, the applicable lock-up period for the cornerstone investment would still apply.

More robust price discovery process

Given the inherent difficulties in valuing Specialist Technology Companies, the Exchange proposes that at least 50% of the total number of shares offered in the IPO (excluding any shares to be issued pursuant to the exercise of any over-allotment option) must be taken up by the independent Institutional Professional Investors (as defined in Securities and Futures Ordinance). This aims to ensure a robust price discovery process that fully benefits from the institutional investors' research and professional assessment.

The Exchange also proposes a revised initial retail allocation and clawback mechanism to the initial listing of Specialist Technology Companies as follows:

Revised initial allocation and clawback mechanism	Initial	Over-subscription in the public placing tranche	
		10 times to < 50 times	50 times or more
Minimum retail allocation (as % of total offer shares)	5%	10%	20%

Additional continuing obligations for Pre-Commercial Companies

The Exchange proposes additional continuing obligations for Pre-Commercial Companies, including (a) additional disclosures in the interim and annual reports in relation to R&D activities and commercialisation progress; (b) shortened remedial period of 12 months to re-comply with the sufficiency of operations requirement before delisting; (c) restriction on effecting any transaction that would result in material change of business without prior consent from the Exchange; and (d) a unique stock marker "PC" for identification.

GEM reform

While it is believed that the introduction of listing regime for Specialist Technology Companies will improve the attractiveness of Hong Kong to new economy companies, the Exchange is also aware that the proposed regime may not necessarily address the fund-raising needs of small and medium sized enterprises, and therefore will explore other ways to address this separately.

If you have any questions about the matters discussed in this publication, please feel free to contact the following capital markets partners and directors.

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