Pro Forma Financial Information under the Hong Kong Listing Rules

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Foreword

As one of the world's leading listing destinations, Hong Kong relies on its investor's confidence in our capital market. This is built upon a number of key success factors, including the quality and reliability of the financial information prepared by our issuers.

Traditionally, investors utilised historical financial data to guide their investment decisions. However, in times of uncertainty and rapid change, prior financial results may not be sufficient to provide investors with a holistic picture of an issuer's financial outlook. In response to this dynamic economic landscape, investors seek to integrate other financial data such as pro forma measures to more accurately assess future prospects of issuers. In conjunction with historical financial information, this hybrid approach could serve to provide a balanced view on the issuer's financial position and results of its operations.

In contrast to the standards surrounding the preparation of historical financial information, there is comparatively limited guidance on the preparation of pro forma financial information, leading to the diversity in practice in the market. Pro forma financials can also be misinterpreted for prospective financials such as financial forecasts. Given its hypothetical nature, the preparation of pro forma financial information presents additional challenges; significant judgments and assumptions are often required to ensure that information presented is meaningful and provides investors with a firm foundation for their investment decisions. This publication serves to introduce the guiding principles for consistent application in the preparation of pro forma financial information under the Hong Kong Listing Rules.

We hope that this publication will provide practical guidance and useful references in dealing with the issues associated with the preparation of pro forma financial information.

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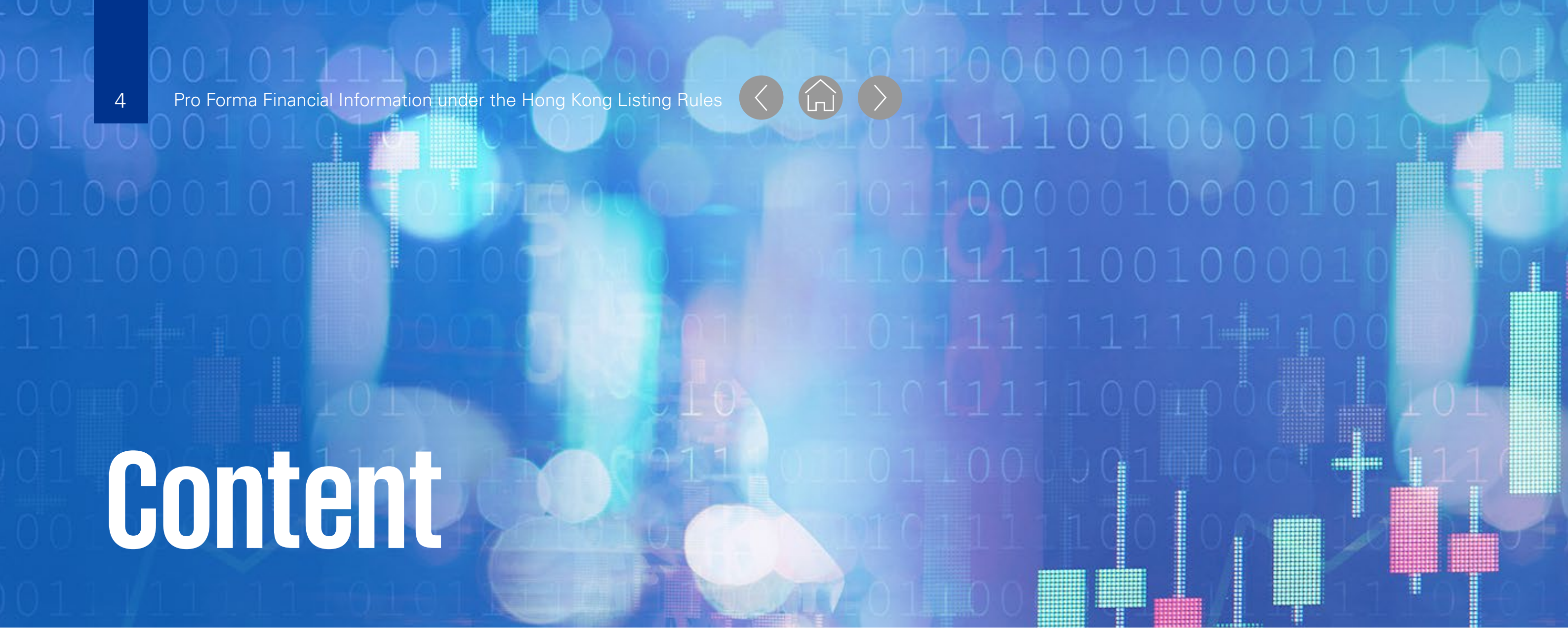
Glossary of terms

The following abbreviations are used in this publication:

AG 7	Accounting Guideline 7, *Preparation of Pro Forma Financial Information for Inclusion in Investment Circulars*, issued by the HKICPA
Circular or Investment Circular	A document issued by an entity relating to securities and for the information or investment decision of the holders of the entity's securities or other parties, including without limitation a listing document, a prospectus, a circular to shareholders or similar document.
Exchange	The Stock Exchange of Hong Kong Limited
Extreme transaction	An acquisition or a series of acquisitions of assets by a listed issuer which meets the criteria set out in MBLR 14.06C or GEMLR 19.06C
De-SPAC transaction	An acquisition of, or a business combination with, a target company by a special purpose acquisition corporation ("SPAC") that results in the listing of a successor company under MBLR Chapter 18B.
GEM Listing Rules or GEMLR	Rules Governing the Listing of Securities on GEM of The Stock Exchange of Hong Kong Limited
Half-year report	The interim report under MBLR or the half-year report under GEMLR
HKAS	Hong Kong Accounting Standards
HKFRS	Hong Kong Financial Reporting Standards, which collective term includes all applicable individual HKFRSs, HKASs and Interpretations, issued by the HKICPA
HKICPA	Hong Kong Institute of Certified Public Accountants
HKSAE 3420	Hong Kong Standard on Assurance Engagements 3420, *Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus*, issued by the HKICPA
IPO	Initial public offering
Issuer	As defined by the Listing Rules, an issuer is any company or other legal person any of whose securities are the subject of an application for listing or some of whose securities are already listed.
Listing Rules	Main Board Listing Rules and GEM Listing Rules, collectively
Main Board	The Main Board of the Exchange
Main Board Listing Rules or MBLR	Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited
Major Transaction	A transaction or a series of transactions by a listed issuer where any percentage ratio in MBLR 14.07 or GEMLR 19.07 is 25% or more, but less than 100% for an acquisition or 75% for a disposal
Notifiable transaction	One of the transactions specified in MBLR 14.06, 14.06B or 14.06C or GEMLR 19.06, 19.06B or 19.06C
Pro forma statement of assets and liabilities	Pro forma statement of assets and liabilities or pro forma net assets statement under the Listing Rules
Pro forma statement of financial position	Pro forma statement of financial position or pro forma balance sheet under the Listing Rules
Pro forma statement of profit or loss	Pro forma statement of profit or loss or pro forma income statement under the Listing Rules
Reporting Accountants	Certified public accountants who are engaged to prepare public reports and letters for inclusion in, or private letters in connection with, an Investment Circular. Where the context requires, this term includes auditors where they are carrying out a role in connection with an Investment Circular, other than that of reporting as auditors on financial statements.
Reverse takeover	An acquisition or a series of acquisitions of assets by a listed issuer which, in the opinion of the Exchange, constitutes, or is part of a transaction and/or arrangement or series of transactions and/or arrangements which constitute, an attempt to achieve a listing of the acquisition targets (as defined in MBLR 14.04(2A)/ GEMLR 19.04(2A)) and a means to circumvent the requirements for new applicants set out MBLR Chapter 8/GEMLR Chapter 11.
Track Record Period	The period for which historical financial information of an Issuer is presented in an Investment Circular
Very Substantial Acquisition	An acquisition or a series of acquisitions of assets by a listed issuer where any percentage ratio in MBLR 14.07 or GEMLR 19.07 is 100% or more
Very Substantial Disposal	A disposal or a series of disposals of assets (including deemed disposals) by a listed issuer where any applicable percentage ratio in MBLR 14.07 or GEMLR 19.07 is 75% or more



Content

Executive summary

Scope and application

The Listing Rules require Issuers to compile and present pro forma financial information under certain situations, and set out a regulatory framework on how Issuers should present such information. The purpose of pro forma financial information is to provide investors with relevant information about the impact of a transaction, which is the subject matter of an Investment Circular.

Listing applicants are required to compile and present pro forma financial information in a prospectus to illustrate the impact of the issuance of new shares as part of an IPO and the acquisition or proposed acquisition of a major subsidiary after the Track Record Period but before listing.

Listed issuers are required to compile and present pro forma financial information in Investment Circulars for certain major transaction, very substantial acquisition, extreme transaction, reverse takeover, De-SPAC transaction, very substantial disposal or issuance of new shares via rights issue and open offers.

This publication summarises the relevant requirements and guidance on the preparation of pro forma financial information under the Listing Rules and our observations on how some of the implementation issues are dealt with in practice.

Outline of this publication

This publication is divided into five main parts:

1. Introduction
2. Format, reporting period and unadjusted information
3. Pro forma adjustments
4. Presentation and disclosures
5. Reporting by reporting accountants

Section 1 gives an overview of the nature of pro forma financial information and a summary of the requirements to prepare pro forma financial information. Section 2 highlights the format for presenting pro forma financial information, which is followed by discussions to assist users of this publication to understand the principles to be considered in choosing the reporting period to be covered by pro forma financial information, a coterminous accounting period for the Issuer and an acquisition target, and the source from which unadjusted information is derived.

Practical issues are expected to arise in the preparation and presentation of pro forma financial information. In addition to setting out the basic criteria which pro forma adjustments need to meet, Section 3 provides real life issues and practical examples on how those can be addressed. For example, presentation of pro forma net tangible assets and issues relating to business combinations, disposal of subsidiaries for notifiable transactions and rights issue situations.

In Section 4, presentation and disclosure requirements for pro forma financial information are discussed. Section 5 then gives an overview of the reporting requirements on pro forma financial information under HKSAE 3420.

To facilitate a better understanding of the principles discussed, illustrative pro forma information presentation and disclosures are set out in the Appendix to this publication.

Section 1

Introduction

The phrase "pro forma" is widely used in the financial markets and often used interchangeably to refer to some non-generally accepted accounting principle ("non-GAAP") measures or forecasts. For example, adjusted net profit, a non-GAAP measure, is sometimes described as pro forma earnings. Such practice causes confusion as to what is pro forma financial information and what is not. In the context of Hong Kong regulatory environment, there is a clear distinction between pro forma financial information, non-GAAP measures and forecast.

Pro forma financial information aims to illustrate how a particular proposed transaction might have affected the unadjusted financial information presented in an Investment Circular had the transaction occurred at an earlier date. As required by the Listing Rules, the pro form financial information should be prepared using the accounting policies adopted by the Issuer.

Non-GAAP measures are alternative accounting measures calculated based on the comparable GAAP measures after making certain adjustments, such as excluding the impacts of certain one-off transaction and non-cash transactions. Typical examples of non-GAAP measures include adjusted profit and earnings before interest and taxes. Compared with the pro form financial information, these measures do not fully comply with the Issuer's accounting policies and the adjustments made to the comparable GAAP measures are not limited to one particular transaction.

A forecast is prospective financial information prepared based on management's assumptions about the future trends. A typical example is the profit forecast for the coming year. Unlike pro forma financial information, a forecast is intended to illustrate future performance of an Issuer as a whole but not the impact of a particular transaction on its historical information, though it is often made with reference to historical information.

This publication is intended to provide guidance on preparation of pro forma financial information under the Listing Rules.

Nature and purpose of pro forma financial information

1.1 The Listing Rules require Issuers to compile and present pro forma financial information under certain situations, and set out a regulatory framework on how Issuers should present such information. Voluntary disclosure of any pro forma information is also subject to the same requirements.

1.2 The preparation of pro forma financial information is the responsibility of the directors of the Issuer. Reporting accountants are required under the Listing Rules to report on pro forma financial information (see section 5).

1.3 The purpose of pro forma financial information is to provide investors with relevant information about the impact of a transaction, which is the subject matter of an Investment Circular. Pro forma financial information illustrates how that transaction might have affected the financial information presented in the Investment Circular had the transaction been undertaken at the beginning of the period reported on or, in the case of a pro forma statement of financial position, pro forma statement of assets and liabilities or pro forma statement of net tangible assets, as at the date reported on.

1.4 Pro forma financial information does not purport to represent what the Issuer's financial position or results would have been had the transaction occurred on the date assumed for the purpose of its preparation. Nor does it purport to show what the Issuer's financial position or results will be once the transaction does occur. Pro forma financial information indicates instead how a transaction might affect the broad outline of the Issuer's financial performance or position.

1.5 As a result of the above, and the fact that pro forma financial information generally does not reflect other transactions and events which are not the subject matter of the Investment Circular, it addresses only a hypothetical situation and is prepared for illustrative purposes only. Users of pro forma financial information are advised to exercise caution when interpreting such information.

1.6 Pro forma financial information presented may be used by shareholders or potential investors in making a decision on whether a proposed transaction should proceed. Issuers are, therefore, encouraged to evaluate whether the information presented is useful or meaningful. Where this is not the case, or the information provided appears misleading, Issuers are encouraged to revisit relevant guidance such as AG 7 and consult professional advisers and the Exchange on how the information could be best presented.

When to present pro forma financial information under the Listing Rules

1.7 The Listing Rules require the presentation of pro forma financial information in certain specific circumstances. Table 1.1 summarises the pro forma financial information required by the Listing Rules under different scenarios.

1.8 The Exchange has the discretion to waive, modify or not require compliance with the Listing Rules. However, it is expected that such discretion will only be made when the facts and circumstances of a particular case justify a departure from the rules.

Table 1.1 Summary of requirements to present pro forma financial information

Issuer	Transaction type	Relevant Rules and Guidance	Requirements
Listing applicants	Issuance of new shares as part of an IPO	MBLR Appendix D1A.21 GEMLR Appendix D1A.21	Statement of the net tangible asset backing for each class of security for which listing is sought, after making allowance for any new securities to be issued *Note: Where a listing applicant has caused any property interests to be valued (in accordance with MBLR Chapter 5 or GEMLR Chapter 8) or has caused any valuation to be made of any other tangible assets and included such a valuation in the prospectus relating to its initial public offering, the listing applicant is required to state in its prospectus, by way of note to the adjusted net tangible asset statement, the additional depreciation (if any) that would be charged against the statement of profit or loss had such assets been stated at valuation.*
	Acquisition or proposed acquisition of a major subsidiary (see note below) after the Track Record Period but before listing *Note: All acquisitions or proposed acquisitions since the date to which the latest financial information in the accountants' report of the Issuer has been made up, whether of businesses or companies, should be aggregated. If the aggregated total assets, profits or revenue represents 5% or more under any of the percentage ratios as defined under MBLR 14.04(9) or GEMLR 19.04(9), these acquisitions will be deemed to be an acquisition of a major subsidiary for the purpose of MBLR 4.28 or GEMLR 7.30.*	MBLR 4.28 GEMLR 7.30	If any of the percentage ratios calculated in accordance with MBLR 4.28/GEMLR 7.30 is 5% or more but is less than 100%, the Issuer should disclose, as a minimum, pro forma statement of assets and liabilities of the enlarged group If any of the percentage ratios calculated in accordance with MBLR 4.28/GEMLR 7.30 is 100% or more, the Issuer should disclose, as a minimum, pro forma statement of financial position, statement of profit or loss and cash flow statement of the enlarged group *Note: The requirements of MBLR 4.28/GEMLR 7.30 do not apply to the acquisitions or proposed acquisitions after the Track Record Period in the Form A1 application proof but will be subsequently covered by the Track Record Period in the final prospectus.*

Table 1.1 Summary of requirements to present pro forma financial information (Continued)

Issuer	Transaction type	Relevant Rules and Guidance	Requirements
Listed issuers	Acquisition constituting a major transaction	MBLR 4.25, 14.67(6)(a)(ii), 14.67(6)(b)(ii) GEMLR 7.27, 19.67(6)(a)(ii), 19.67(6)(b)(ii)	Pro forma statement of assets and liabilities of the enlarged group
	Very substantial acquisition, extreme transaction or reverse takeover	MBLR 4.26, 14.69(4)(a)(ii), 14.69(4)(b)(ii) GEMLR 7.28, 19.69(4)(a)(ii), 19.69(4)(b)(ii)	For acquisition of a business or company: pro forma statement of profit or loss, statement of financial position and cash flow statement of the enlarged group For acquisition of revenue-generating assets: pro forma profit and loss statement and statement of assets and liabilities of the enlarged group
	Very substantial disposal	MBLR 4.27, 14.68(2)(a)(ii), 14.68(2)(b)(ii) GEMLR 7.29, 19.68(2)(a)(ii), 19.68(2)(b)(ii)	For disposal of a business or company: pro forma statement of profit or loss, statement of financial position and cash flow statement of the remaining group For disposal of revenue generating assets: pro forma profit and loss statement and statement of assets and liabilities of the remaining group
	Issuance of new shares via rights issue and open offers	MBLR Appendix D1B.13 GEMLR Appendix D1B.13	Statement of net tangible asset backing for each class of security for which listing is sought, after making allowance for any new securities to be issued

Section 2

Format, reporting period and unadjusted information

Format and prominence of pro forma financial information

2.1 The Listing Rules require pro forma financial information to be presented in a columnar format as follows:

(a) The first column showing the unadjusted financial information of the Issuer on which the effect of the transaction is illustrated (see section 2.16 for details);

(b) Subsequent columns reflecting adjustments for the effect of the transaction which is the subject of the Investment Circular (see section 3 for details); and

(c) The final column displaying the resultant adjusted amounts.

In practice, for transactions involving acquisition or disposal of a company, some Issuers prefer to present the financial information of the target company, which is directly extracted from an accountants' report without adjustments, as a separate column followed by subsequent columns reflecting other pro forma adjustments.

2.2 Pro forma financial information must be given no greater prominence in an Investment Circular than historical financial information.

Reporting period or date

2.3 The Listing Rules require that pro forma financial information may only be published in respect of:

(a) The current financial period;

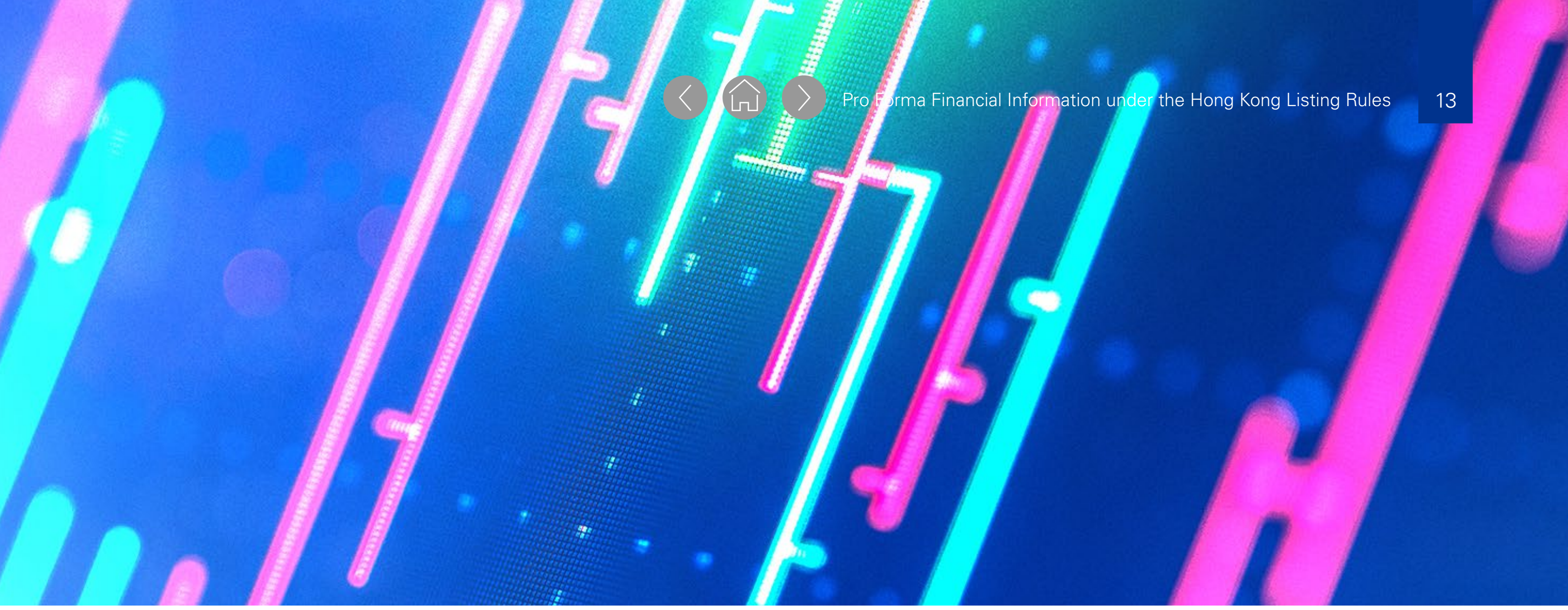
(b) The most recently completed financial period; and/or

(c) The most recent interim period for which the relevant unadjusted information has been or will be published or is being published in the same document.

and, in the case of a pro forma statement of financial position or statement of assets and liabilities, as at the date on which such periods end or ended.

2.4 Presenting pro forma financial information for any period preceding the most recently completed financial period is precluded under the Listing Rules.

2.5 A financial period is only regarded as completed when the full period has ended and financial information for that period has been published. Therefore, the "current financial period" and the "interim period for which the relevant information will be published", as set out in sections 2.3(a) and (c) respectively, refer mainly to cases where the source of the unadjusted information is derived from a profit forecast or estimate for a period for which financial information has not yet been published (see section 2.16). For example, if a listing applicant discloses pro forma earnings per share information based on its profit forecast for the year ending 31 December 20X3, then the pro forma information is prepared in respect of the current financial period, i.e. the unexpired financial year ending 31 December 20X3.



Example 1

Columnar format of pro forma financial information – pro forma statement of assets and liabilities of the enlarged group in an acquisition transaction constituting a major transaction for a listed issuer

		Pro forma adjustments		
	Unadjusted information of the Issuer as of 31 Dec 20X2	**The Acquisition Target as of 31 Dec 20X2**	**Acquisition consideration and purchase price allocation**	**Pro forma adjusted information as of 31 Dec 20X2**
	$'m	*$'m*	*$'m*	*$'m*
Non-current assets				
Property, plant and equipment	1,500	500	100	2,100
Goodwill	-	-	100	100
	1,500			**2,200**
Current assets				
Inventories	500	200	-	700
Trade and other receivables	300	100	-	400
Cash at bank and in hand	1,000	50	(900)	150
	1,800			**1,250**
Current liabilities				
Trade and other payables	200	100	-	300
Current taxation	100	50	-	150
	300			**450**
Net current assets	**1,500**			**800**
Non-current liabilities				
Bank loans	300	-	-	300
Other loans	200	-	-	200
	500			**500**
NET ASSETS	**2,500**			**2,500**

Note: For the purpose of this pro forma financial information, no deferred tax was assumed.

2.6 Requirements in section 2.3 allow the presentation of pro forma financial information for more than one period or at more than one date. In practice, however, it may not serve a useful purpose to present the pro forma statement of assets and liabilities or statement of financial position at more than one date unless there are specific facts and circumstances warranting such presentation.

Reporting period for pro forma statement of profit or loss – must it end on the reporting date for the pro forma statement of financial position?

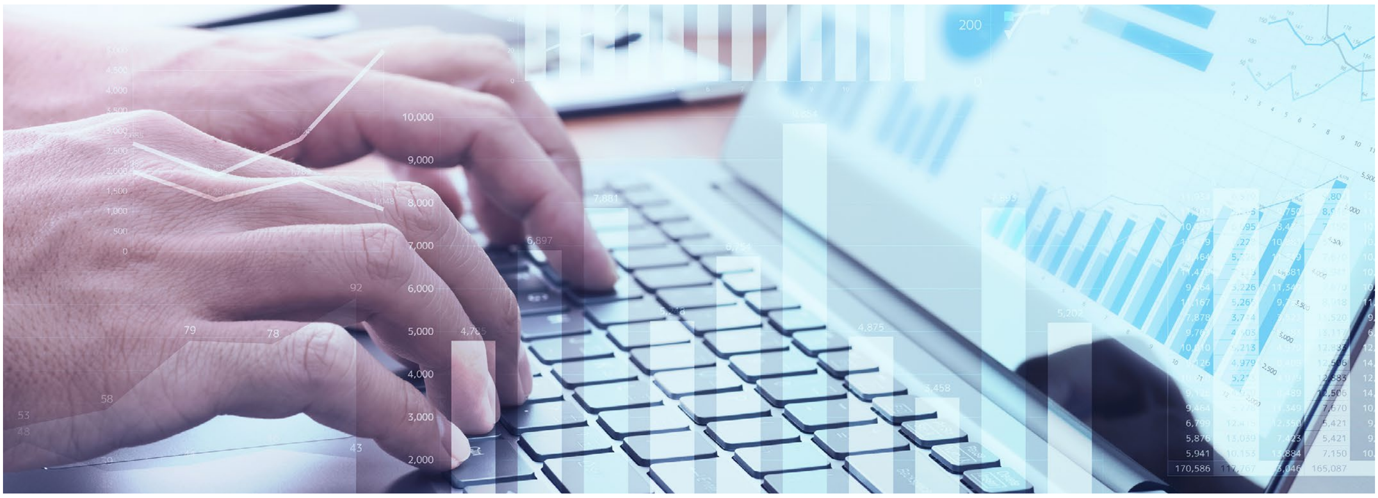
2.7 Unlike the different primary statements in a set of historical financial statements reflecting different aspects of the same transactions, pro forma financial information lacks articulation, i.e. a pro forma statement of financial position does not reflect the cumulative impact of the adjustments to pro forma statement of profit or loss. Therefore, pro forma financial information does not purport to represent what the Issuer's financial position or results would have been had the transaction occurred on the date assumed.

2.8 By way of example, it is appropriate to assume for the purpose of pro forma statement of profit or loss that an acquisition is completed at the beginning of the period. Fair value adjustments on property, plant and equipment will then affect depreciation charges for the period presented. The pro forma statement of financial position at the end of the period will not reflect such additional depreciation charges, but instead assumes that the acquisition is only completed at the end of the period.

2.9 In situations where both pro forma statement of financial position (or statement of assets and liabilities) and pro forma statement of profit or loss (and cash flow statement) are presented in the same document, it is possible that the reporting date chosen for presenting the pro forma statement of financial position (or statement of assets and liabilities) can be different from the end of the reporting period chosen for presenting the pro forma statement of profit or loss (and cash flow statement) in the same document. An Issuer is allowed to choose any reporting date or period to the extent allowed under MBLR 4.29(4), or GEMLR 7.31(4), therefore, the reporting date chosen for a pro forma statement of financial position (or statement of assets and liabilities) can be different from the end of the reporting period for presenting a pro forma statement of profit or loss (and cash flow statement). While different options are available, an Issuer should choose the most appropriate reporting dates based on its own facts and circumstances, which, for example, include

- the availability of financial information (e.g. whether the Issuer and the target company have financial information for the same period in terms of length or at the same date); and
- the seasonal effects of the Issuer's and the target company's businesses.

2.10 In practice, it is not uncommon to see Issuers using different reporting dates for pro forma statement of financial position (or statement of assets and liabilities) and pro forma statement of profit or loss (and cash flow statement). Issuers tend to choose the period end date of the financial statements contained in the latest published half-year report or annual report, whichever is more recent, as the reporting date for pro forma statement of financial position (or statement of assets and liabilities), with a view of providing investors with the Issuers' latest financial position. In contrast, pro forma statement of profit or loss (and cash flow statement) is commonly published in respect of the latest completed financial year to prevent the Issuers' financial results (and cash flows) from being distorted by seasonal factors.



Example 2

Company A, a December year end company, is engaged in the manufacture of chopsticks. The business does not demonstrate seasonality in sales. Published historical financial information for the year ended 31 December 20X2 and the six months ended 30 June 20X3 is available. Recognising the choices available as described in section 2.9 and assuming Company A does not elect to present pro forma financial information for more than one period or at more than one date, Company A may present the pro forma statement of profit or loss and statement of financial position as at and for the following periods:

Possible alternatives	Pro forma statement of profit or loss	Pro forma statement of financial position
1	Year ended 31 December 20X2	As at 31 December 20X2
2	Year ended 31 December 20X2	As at 30 June 20X3
3	Six months ended 30 June 20X3	As at 31 December 20X2
4	Six months ended 30 June 20X3	As at 30 June 20X3

While the Listing Rules may suggest that the above four alternatives are acceptable, many Issuers tend to adopt alternative 2 in practice, in the absence of other specific considerations.

In contrast, alternative 3 seems to be the least preferable option, because the combination of the statement of profit or loss for the latest June 20X3 interim period with a less up-to-date 31 December 20X2 statement of financial position is less likely to serve a useful purpose, unless there are specific facts and circumstances that could justify such a combination.

Example 3

Company B, a December year end company, proposes to acquire a target company (the “Target Company”), which constitutes a very substantial acquisition. The Target Company is a pharmaceutical company incorporated on 1 January 20X2. The total consideration is RMB100 million, of which RMB80 million will be allocated to an intangible asset with a useful life of 4 years. It is mainly engaged in the research and development (“R&D”) activities and incurred RMB30 million R&D expenses in 20X2 and starts to generate revenue from January 20X3 after obtaining the required licenses. Published historical financial information for the year ended 31 December 20X2 and the six months ended 30 June 20X3 is available for both Company B and the Target Company. Despite the fact that the four alternatives (see Example 2) are available for Company B, Company B may wish to prepare the pro forma statement of profit or loss and cash flow statement for the six months ended 30 June 20X3, because such information captures the Target Company’s latest business development and enables the investors to make more meaningful analysis on how the acquisition of Target Company might affect Company B’s financial performance. In contrast, preparing the pro forma statement of profit or loss and cash flow statement for the year ended 31 December 20X2 is the least preferred option because, in addition to the RMB30 million R&D expenses, a pro forma adjustment would be made to record RMB20 million amortisation costs on the intangible asset, which has the risk of double counting the R&D costs for the year ended 31 December 20X2.

Example 4

Company C, an existing listed company on Shanghai Stock Exchange, proposes to list its H shares on the Main Board of the Exchange in May 20X3. The accountants’ report in the prospectus included the consolidated financial information of Company C for the three years ended 31 December 20X2. In addition to the accountants’ report, Company C also included the interim financial information for the first quarter of 20X3 in the prospectus because it published the relevant information in accordance with the regulatory requirements of Shanghai Stock Exchange subsequent to the Track Record Period. The interim financial information has been reviewed by the reporting accountants in accordance with Hong Kong Standard on Review Engagements 2410 “Review of Interim Financial Information Performed by the Independent Auditor of the Entity” issued by the HKICPA.

Company C should prepare the pro forma net tangible assets per share based on the financial information at 31 December 20X2 instead of 31 March 20X3 because the interim financial information for the first quarter of 20X3 is not allowed to be used as the source of unadjusted financial information (see section 2.16).

Acquisitions and accounting periods – is it acceptable to use non-coterminous year end dates?

2.11 When presenting pro forma financial information to illustrate the impact of an acquisition, one has to consider the accounting periods that the pro forma information should cover for both the acquirer and the acquiree.

2.12 Where pro forma profit or loss and cash flow information is presented, the unadjusted information about the Issuer and the adjustments in respect of the acquiree should cover periods of the same length. It is common for Issuers to present such information for a full financial year such that there is no distortion due to seasonal factors and that the estimated contribution of the transaction to a full year's results of the Issuer can be assessed by the investors.

2.13 Whilst desirable, it is not normally necessary to use coterminous accounting periods.

Example 5

Company D proposes to acquire Company E, which constitutes a very substantial acquisition for Company D. For inclusion in a circular for the transaction, Company D is preparing a pro forma statement of profit or loss using its latest 31 December year end results as the unadjusted information. While Company D has a December year end, Company E has a September year end. If the 12-month statement of profit or loss information of Company E is only available up to the preceding 30 September, that information could generally be used for the purpose of making an adjustment to derive at a pro forma statement of profit or loss.

2.14 Where businesses are seasonal, an Issuer has to consider whether the use of non-coterminous accounting periods will distort the purpose of presenting pro forma information. Where pro forma interim information is presented and seasonal factors are significant, coterminous accounting periods may be required to prevent the information from being misleading. Where the dates of the information used are not coterminous, the Issuer should disclose that fact and the reasons therefor.

2.15 Non-coterminous accounting periods may also be of concern when preparing pro forma statement of assets and liabilities or statement of financial position if there are significant seasonal variations.

Example 6

Company F, a retailer of swimsuits, is going to acquire Company G, a retailer of overcoats. Company F typically has a higher inventory level at 30 June while Company G has its highest inventory level at 31 December. The preparation of a pro forma statement of financial position using 30 June information of Company F and 31 December information of Company G may be misleading in that following the completion of the acquisition of Company G, Company F is not expected to show high levels of swim suit and overcoat inventories at the same time. Company F should consider presenting coterminous information instead, with an explanatory note.

Source of the unadjusted information

2.16 Unadjusted information must be derived from the most recent:

(a) Audited published financial statements, published half-year reports or published half-year or annual results announcements;

(b) Accountants' report;

(c) Previously published pro forma financial information reported on in accordance with MBLR 4.29(7) or GEMLR 7.31(7); or

(d) Published profit forecast or estimate.

2.17. In practice, there are a very limited number of cases using previously published pro forma financial information as the source of the unadjusted information. An Issuer should consider whether the use of previously published pro forma financial information as a starting point for pro forma financial information will give meaningful information to investors. This may not be the case if the transaction being the subject matter of the previously published pro forma financial information has not yet been approved by shareholders or is not otherwise completed as of the date of the subsequent circular, or if that transaction has been completed but the actual impact of that transaction on the Issuer's financial information turns out to be significantly different from that which the previously published pro forma financial information suggests.

Example 7

Company H is a company listed on the Main Board of the Exchange and has a December financial year end. It has published its audited financial statements for the financial year ended 31 December 20X2, interim report for the six months ended 30 June 20X3 and summarised financial information disclosed for the nine months ended 30 September 20X3.

Company H may present pro forma financial information as of and for the year ended 31 December 20X2 and/or as of and for the six months ended 30 June 20X3, being the most recent period ends for which the company has published audited financial statements and interim report, respectively. Summarised financial information as of and for the nine months ended 30 September 20X3 is generally not used as the source of the unadjusted information as it is not considered a published interim report which complies with the Listing Rules. Even if Company H was listed on GEM, the GEM Listing Rules would also prohibit the use of quarterly financial information in the 30 September 20X3 quarterly report as the source of unadjusted information.

Section 3

Pro forma adjustments

3.1 Pro forma adjustments need to meet the following criteria:

(a) Clearly shown and explained;

(b) Directly attributable to the transaction concerned and not relating to future events or decisions;

(c) Factually supportable; and

(d) In respect of a pro forma statement of profit or loss or cash flow statement, clearly identified as to those adjustments which are expected to have a continuing effect on the Issuer and those which are not.

3.2 An Issuer needs only reflect those adjustments which are material, i.e. those that are likely to influence the decisions of investors. The materiality of an item is determined not only by its size but also by the qualitative factors of its nature and circumstances.

Clearly shown and explained

3.3 To fulfil the "clearly shown and explained" criterion, Issuers should include notes to the pro forma financial information that set out:

(a) Any assumptions on which the adjustments are based;

(b) The range of possible outcomes where there is significant uncertainty;

(c) The sources of the amounts concerned; and

(d) Where relevant, how adjustments have been aggregated or allocated to financial statement captions.

Attributable to the transaction

3.4 The purpose of the pro forma financial information is to provide investors with information about the impact of the subject transaction of the Investment Circular by illustrating how that transaction might have affected the financial information presented in the Investment Circular. Accordingly, MBLR4.29 (1) and (6) (or GEMLR 7.31 (1) and (6)) require the pro forma adjustments to be restricted to those directly attributable to, or those which form an integral part of, the transaction. Generally no adjustments should be made in respect of subsequent events apart from those which meet the adjustment criteria. Pro forma financial information should not include adjustments which are dependent on actions to be taken upon or after completion of the transaction, even where such actions are relevant to the Issuer's purpose in entering into the transaction. Whether two or more different transactions should be reflected in pro forma financial information would depend on whether they are interlocking components of the subject matter of the circular.

Example 8

Company A issues a circular for the acquisition of a new production plant which constitutes a major transaction. Upon acquiring the new production plant, Company A intends to close down certain of its existing production sites.

The closing down of existing production sites relates to future events which are not directly attributable to the transaction that is the subject matter of the circular (i.e. the acquisition of the new production plant). As a result, the closing down of the existing production sites should not be reflected in the pro forma financial information. Company A should, however, disclose the closing down of the existing production sites in the notes to the pro forma financial information, noting that this has not been reflected or included as a pro forma adjustment.

Example 9

The subject of the circular of Company B is the acquisition of a major asset, which is conditional on the raising of a bank loan from Bank C at specified terms to finance it, and vice versa. The two transactions (i.e. the acquisition of the asset and the raising of the bank loan) are an integral part of the whole transaction, and they are regarded as interlocking components of the transaction. This is different from the facts in Example 8 where, although the closing down of existing sites is a foreseeable and reasonable consequence of the acquisition of the new production plant, it is not an interlocking component of the subject matter of the circular.

To enable readers to more easily understand the whole transaction, the interlocking elements of the transaction may be separately described with supporting note disclosure of each component.

3.5 Restructuring costs, new management compensation packages and new contractual arrangements are other examples of matters that are not normally reflected as pro forma adjustments.

3.6 In practice, the Exchange granted a very limited number of waivers to Issuers for making adjustments not directly attributable to the subject transaction of the Investment Circulars. In those cases, the Issuers usually have significant restructuring or acquisitions and making adjustments in connection with these restructuring or acquisition would assist the investors in analysing the financial information and future prospects of the Issuers. However, Issuers are advised to consult the Exchange before deviating from the "attributable to the transaction" requirement.

Subsequent events

3.7 As a general principle, an Issuer is not expected to make adjustment in respect of a subsequent event other than the subject of the Circular, unless such subsequent event qualifies as an adjusting event under HKAS10 and is reflected in the unadjusted financial information of the Issuer. If an Issuer believes that pro forma financial information is misleading because it does not reflect significant subsequent events, it should consider disclosing the relevant events in the notes to the pro forma financial information so as to prevent the information from being misleading.

Example 10

In June 20X3, Company C proposes to acquire Company D and the proposed acquisition constitutes a major transaction. Company C presents a pro forma statement of assets and liabilities as at 31 December 20X2 in the circular for the proposed acquisition. In March 20X3, Company C declared a special dividend which was paid in May 20X3 and which constitutes a significant amount compared to net assets of Company C. The declaration and payment of the dividend, being a non-adjusting subsequent event and not directly attributable to the transaction, should not be included as a pro forma adjustment. Company C should, however, include a note to the pro forma financial information about the declaration and payment of dividend, to prevent the pro forma information from being misleading.

3.8 Despite the general principle outlined in section 3.7 that Issuers do not make adjustments for subsequent events, in rare circumstances, adjustments for other transactions or issues of capital that have led to announcements or circulars under the Listing Rules may be permitted where this is necessary to ensure that pro forma financial information is not misleading. Further, as described in sections 2.16 and 2.17, previously published pro forma financial information reported on in accordance with MBLR 4.29(7) or GEMLR 7.31(7) can be used as a starting point for the preparation of pro forma financial information for a subsequent transaction. The requirement that the resulting pro forma financial information is not misleading precludes cherry-picking transactions for which adjustments are made.

Factually supportable

3.9 Pro forma adjustments must be supported by facts. The nature of facts supporting an adjustment will vary according to the circumstances.

3.10 Examples of factual support for pro forma adjustments include the following:

(a) the financial information of the acquiree is extracted from the accountants' report of the acquiree disclosed in the Investment Circular;

(b) the financial information of the divestee is usually based on the amounts recorded in the consolidated financial statements of the Issuer on which the unadjusted financial information is based;

(c) the consideration for the transaction is set out in the purchase and sale agreements;

(d) the transaction costs are determined based on the contracts signed between the Issuer and the professional parties; and

(e) the adjustments made as a result of the purchase price allocation in an acquisition are usually based on a preliminary valuation report.

Continuing effects

3.11 In respect of a pro forma statement of profit or loss or cash flow statement, an Issuer has to clearly identify those adjustments which are expected to have a continuing effect on the Issuer and those which are not. This disclosure requirement is designed to assist the users of the pro forma financial information in distinguishing between the one-time effect and the on-going effect of the transaction. Issuers are advised to take note of this disclosure requirement such that this is not missed out in pro forma disclosures.

3.12 An example of adjustments that are expected to have a continuing effect would be the incremental depreciation and amortisation expenses as a result of fair value adjustments in relation to the tangible and intangible assets of the acquired business. Examples of adjustments that do not have a continuing effect include: the gain or loss resulting directly from a very substantial disposal, the non-recurring credit or gain arising from a bargain purchase in a business acquisition, and transaction costs that are directly attributable to the transaction.

Pro forma adjustments in relation to an IPO – practical issues

Net tangible assets

3.13 As illustrated in Table 1.1, pursuant to MBLR Appendix D1A.21 and GEMLR Appendix D1A.21, a listing applicant is required to disclose a statement of net tangible asset backing for each class of security for which listing is sought, after making allowance for any new securities to be issued. It is common practice for listing applicants to satisfy this requirement by presenting pro forma net tangible assets per share information, illustrating what net tangible assets per share as at the latest reporting date in the Track Record Period would have been had the IPO been completed on that date. In presenting such information, pro forma adjustments are made to reflect the impact of the proceeds from the issuance of new shares on net tangible assets, and the impact of the new shares to be issued on the number of outstanding shares. In addition to those, a listing applicant has to consider if other pro forma adjustments, to the extent directly attributable to the IPO and factually supportable, are required to be made.

3.14 The Listing Rules do not define what constitutes the net tangible assets. In practice, many listing applicants calculate the net tangible assets by deducting certain "intangible" items from the total equity attributable to the equity shareholders of the listing applicants. Commonly seen "intangible" items include intangible assets within the scope of HKAS 38 Intangible Assets and goodwill.

Group reorganisation

3.15 In many IPO transactions for listing in Hong Kong, the listing applicant undergoes a group reorganisation before listing. If the group reorganisation has been completed during the Track Record Period, the financial information presented in the accountants' report should have already reflected the impact of the reorganisation on net assets and the share structure of the listing applicant. As a result, under such a situation, in the preparation of pro forma information in respect of net tangible assets, no further pro forma adjustments are required to reflect the impact of the group reorganisation. Pro forma adjustments will be required for the issuance of new shares as part of the IPO.

3.16 Where the group reorganisation is not completed before the end of the Track Record Period, historical financial information presented in the accountants' report is generally prepared on a combined basis, "as if" the group reorganisation has been completed at the beginning of the Track Record Period. Such combined financial information does not, however, reflect the shares to be issued by the to-be listed holding company as part of the group reorganisation to acquire the businesses to be listed. In calculating the pro forma net tangible assets per share, adjustments should generally be made to reflect the share structure of the to-be listed company upon completion of the IPO, i.e. its share structure after completion of the group reorganisation and the issuance of new shares as part of the IPO.

Example 11

Background

In preparation of the listing on the Exchange, listing applicant Company E underwent a group reorganisation after the Track Record Period, pursuant to which Company E issued 100 million shares to the controlling shareholder Company F in exchange for all operating companies previously held by Company F being the listing businesses transferred to the listing applicant. Net tangible assets using a combined basis as stated in the accountants' report of the listing businesses to be transferred are $600 million and the estimated net proceeds from the IPO are $200 million. Listing applicant Company E had 400 million shares in issue prior to the issue of 100 million new shares to Company F and a further 200 million new shares will be issued in the initial public offering.

Calculation

Pro forma net tangible assets per share

$$= \frac{\text{(Net tangible assets per accountants' report + Net offering proceeds from IPO)}}{\text{(Number of shares in issue + shares issued pursuant to group reorganisation + new shares to be issued upon IPO)}}$$

$$= \frac{(\$600 + \$200)\text{ million}}{(400 + 100 + 200)\text{ million shares}}$$

$$= \$1.14 \text{ per share}$$

The net offering proceeds on the IPO together with the shares issued pursuant to the group reorganisation and the shares to be issued in the offering should be taken into account when calculating the pro forma net tangible assets per share since they all are an integral part of the IPO transaction.

Example 12

Background

Same facts as in Example 11, except that in addition to the issuance of 100 million shares to Company F, Company E also paid cash of $100 million to Company F as part of the group reorganisation.

Calculation

Pro forma net tangible assets per share

$$= \frac{\text{(Net tangible assets per accountants' report + Net offering proceeds from IPO – cash distribution as part of the group reorganisation)}}{\text{(Number of shares in issue + shares issued pursuant to group reorganisation + shares to be issued upon IPO)}}$$

$$= \frac{(\$600 + \$200 - \$100)\text{ million}}{(400 + 100 + 200)\text{ million shares}}$$

$$= \$1 \text{ per share}$$

Shares issued and cash paid as part of the group reorganisation are considered interlocking components (i.e. an integral part) of the IPO transaction, and are included as pro forma adjustments. The basis for calculating pro forma net tangible assets (i.e. taking into account shares issued and cash paid as part of the group reorganisation) should be disclosed in a note to the pro forma net tangible assets statement.

Convertible redeemable preference shares

3.17 Some listing applicants have convertible redeemable preference shares outstanding prior to the IPO. Question often arises as to whether the impact of the conversion of such instrument into ordinary shares after the Track Record Period should be reflected as pro forma adjustments. The treatment depends on whether the listing applicant is able to demonstrate that the conversion is directly attributable to the IPO. For example, if the instrument is automatically converted into ordinary shares upon the completion of the IPO, such conversion is directly attributable to the IPO and accordingly its impact should be reflected as adjustments in calculating the pro forma net tangible assets per share. In contrast, if the conversion is at the discretion of the instrument holders and there is no committed conversion disclosed in the IPO prospectus, the potential conversion is not directly attributable to the IPO and accordingly its impact should not be reflected as pro forma adjustment. Listing applicants are advised to include detailed disclosure of whether the conversion of such instruments is included as pro forma adjustments and the reasons thereof.

Dividends

3.18 Whether dividends declared after the Track Record Period of a listing applicant should be adjusted in determining pro forma net tangible assets per share would again depend on whether the dividend is an integral part of the group reorganisation of the listing applicant for the IPO. Dividends which are declared at management's discretion and do not form part of the group reorganisation should not be adjusted.

Example 13

Listing applicant Company G is a state-owned enterprise incorporated in Country XYZ. Latest statement of financial position presented in the prospectus is as at 31 December 20X2. On 1 February 20X3, for the purpose of transforming Company G into a joint stock company for its proposed IPO, Company G declared a special dividend of $5 million to its parent company (which is a requirement pursuant to relevant laws and regulations). As the declaration of dividend is a regulatory requirement for the IPO transaction to proceed, the dividend may be taken into account in the preparation of pro forma net tangible assets.

Example 14

Listing applicant Company H is a company incorporated in Hong Kong. Latest statement of financial position presented in the prospectus is as at 31 December 20X2. On 1 February 20X3, Company H declared and paid an annual dividend for the year ended 31 December 20X2, although there was no regulatory requirement to do so. The declaration of dividend is not an integral part of the IPO, hence the dividend should not be taken into account in the preparation of pro forma net tangible assets. Instead, Company H should disclose the amount of dividends subsequently declared in a note to the pro forma financial information, together with the fact that the dividends paid have not been taken into account in determining pro forma net tangible assets.

Capitalisation of shareholders' loan

3.19 Sometimes, loans from the majority shareholder will be waived and capitalised prior to the IPO of the listing applicant. Whether the capitalisation of shareholders' loan should be reflected as a pro forma adjustment in the pro forma net tangible assets per share will again depend on whether the listing applicant is able to demonstrate that it is directly attributable to the IPO. For example, if the capitalisation of the shareholders' loan is conditional on the approval of the IPO by the listing committee of the Exchange or is part of the group reorganisation for the purpose of the IPO, it can be considered to be directly attributable to the IPO and accordingly should be reflected as a pro forma adjustment in the pro forma net tangible assets per share.

Major acquisitions subsequent to the Track Record Period

3.20 While not common in practice, a listing applicant may have an acquisition or proposed acquisition of a major subsidiary after the Track Record Period but before listing. In such circumstances, in addition to the requirement under MBLR Appendix D1A.21 (or GEMLR Appendix D1A.21) to present pro forma net tangible assets per share, it has to comply with MBLR 4.28 (or GEMLR 7.30) to present pro forma statement of financial position, statement of profit or loss and cash flow statement or statement of assets and liabilities of the enlarged group taking into account the acquisition or proposed acquisition. Listing applicants should consider how to comply with these two requirements in an Investment Circular.

3.21 If the listing applicant's prospectus discloses that the acquisition is to be financed by the IPO proceeds, then the IPO and the acquisition are interlocked and accordingly the listing applicant should present a single set of pro forma financial information adjusting for both the IPO and the acquisition.

3.22 In contrast, if the IPO and the acquisition are not interlocked as described in section 3.21, the listing applicant should present the pro forma financial information under MBLR 4.28 (or GEMLR 7.30) and MBLR Appendix D1A.21 (or GEMLR Appendix D1A.21) separately. As for the pro forma net tangible assets information under MBLR Appendix D1A.21 (or GEMLR Appendix D1A.21), the listing applicant can choose to prepare it based on either (a) the historical financial information of the listing applicant presented in the accountants' report of the IPO prospectus; or (b) the pro forma financial information of the enlarged group as required under MBLR 4.28 (or GEMLR 7.30). In practice, option (a) is normally adopted.

Earnings per share (EPS)

3.23 The Listing Rules do not require the disclosure of pro forma EPS information. However, if such information is presented, MBLR 4.29 or GEMLR 7.31 and the guidance in AG 7 should be followed.

3.24 Where pro forma EPS information is presented for an IPO transaction, pro forma adjustments are made such that the denominator for calculating pro forma EPS includes the number of shares issued upon completion of the reorganisation, if any, and the number of shares to be issued under the IPO, "as if" they have been issued at the beginning of the financial period. However, the profit used as the numerator either has not reflected the potential impact of the proceeds from the share issuance on the listing applicant's profit or loss (in case of historical profit used) or reflects such potential impact only from the listing date (in case of forecast profit used) while the shares to be issued under the IPO are assumed to be issued as of the beginning of the financial period in calculating the the weighted average number of shares outstanding during the period as the denominator. As a result of the "mismatch" between the numerator and the denominator, a listing applicant should consider whether pro forma EPS is meaningful to potential investors.

3.25 Under MBLR 17.02(1)(b) or GEMLR 23.02(1)(b), a listing applicant must also disclose in the prospectus full details of all outstanding options and their potential dilution effect on shareholding upon listing as well as the impact on the earnings per share arising from the exercise of such outstanding options. As the subject matter of the prospectus is the listing applicant's IPO rather than exercise of share options, pro forma financial information should show the impact of the IPO rather than the exercise of options. The option disclosure requirements will not, therefore, be dealt with as part of the pro forma financial information, but the information required under the Listing Rules should be disclosed elsewhere in the prospectus, for example, in the pre-IPO share option section.

Pro forma adjustments in relation to other capital market transactions – practical issues

Business combinations

Consistent accounting policies

3.26 Pro forma financial information should be presented in a manner consistent with the accounting policies adopted by the Issuer in its financial statements. This applies to adjustments made in respect of an acquisition target. This will not normally cause any difficulties where there is an accountants' report on the acquisition target in a very substantial acquisition or major transaction, as the target's financial information included in the accountants' report has to be prepared in accordance with the Issuer's accounting policies.

3.27 In practice, there are cases where the target company is listed on another stock exchange and publishes its financial statements periodically in accordance with the accounting standards other than those adopted by the Issuer. In such case, the Issuer may apply to the Exchange a waiver from inclusion of an accountants' report on the target company in its circular. Instead, the Issuer may reproduce the target company's published financial statements in its circular and include a line-by-line reconciliation of the target company's financial information under the target company's and its own accounting policies. As for preparing the pro forma financial information, the Issuer may utilise such reconciliation as the basis for making adjustments in respect of the target company's financial information.

3.28 Where the acquiree has undertaken transactions that the Issuer has not previously entered into, accounting policies followed in the compilation of pro forma financial information should be consistent with policies that the Issuer would have adopted for such transactions under its applicable financial reporting framework. Issuers are encouraged to disclose, in a note to the pro forma financial information, such accounting policies adopted in the preparation of the pro forma financial information.

Asset acquisition or business combination?

3.29 In practice, there are often questions surrounding whether a proposed transaction constitutes a business combination or an asset acquisition, which are accounted for using different methods.

3.30 An acquisition that qualifies as a business combination are accounted for using the acquisition method in accordance with HKFRS 3 Business Combination. Under the acquisition method, the acquirer measures most identifiable assets and liabilities at their acquisition-date fair values, with exceptions for certain items such as deferred tax and pension obligations. The acquirer also recognises non-controlling interests, goodwill or gains on bargain purchase where appropriate.

3.31 In contrast, if the assets acquired in an acquisition do not meet the definition of a business under HKFRS 3, the transaction is accounted for as an acquisition of an asset or group of assets. In such cases, the purchase consideration is allocated to the individual identifiable assets acquired and liabilities assumed on the basis of their relative fair values at the date of purchase. Such a transaction will not give rise to goodwill.

3.32 Since the different accounting treatments in sections 3.30 and 3.31 can have a material impact on the pro forma financial information, an Issuer shall determine the nature of the proposed transaction in accordance with HKFRS 3 at the time of compiling the pro forma financial information, rather than wait until publishing the interim or annual financial statements subsequently.

Purchase price allocation and goodwill

3.33 Where a listed issuer acquires a company or business which constitutes a major transaction, very substantial acquisition, extreme transaction, reverse takeover or a De-SPAC transaction, pro forma financial information on the enlarged group has to be presented (see table 1.1).

3.34 For the compilation of the pro forma statement of financial position or statement of assets and liabilities, an Issuer will generally select the latest available published annual or interim financial information as the unadjusted information (i.e. the starting point). The historical assets and liabilities of the target company at a particular point in time (preferably coterminous with the Issuer, see sections 2.11 to 2.15) will then be reflected as pro forma adjustments.

3.35 As the acquisition will not have been completed when the circular is issued, pro forma financial information of the enlarged group can only be compiled using a historical statement of financial position of the target company as pro forma adjustments. An Issuer in preparing the pro forma financial information would have to estimate the fair value of the underlying assets and liabilities of the target company being purchased and, if applicable, the fair value of the consideration transferred and any previous equity interest in the target company. These require the judgement of the Issuer and whether the involvement of other experts is required would depend on the facts and circumstances of a particular case.

3.36 An Issuer should disclose the basis and assumptions for estimating the fair value mentioned in section 3.35 and how the resulting goodwill arising from the acquisition as pro forma adjustments is calculated.

3.37 When the acquisition is subsequently completed, the Issuer will have to perform a purchase price allocation for financial reporting purposes using the information available as at the date of completion of the acquisition. The fair value of net assets acquired and resulting goodwill calculated at the date of completion will likely be different from the amounts disclosed in the pro forma financial information contained in the acquisition circular. This fact should also be disclosed in a note to the pro forma financial information.

Example 15

Listed issuer Company K issued a circular on 30 April 20X3 for a very substantial acquisition of the entire equity interest in Target L, for a consideration of $200 million. Unadjusted information of Company K and Target L as of 31 December 20X2 was used for compiling pro forma financial information of the enlarged group. Fair value of net assets of Target L was estimated to be $100 million. For the purpose of the pro forma information, goodwill is determined to be $100 ($200 - $100) million. Company K makes a note disclosure in the pro forma financial information that goodwill on acquisition upon completion of the acquisition will likely be different depending on changes in various factors including the then net asset value of Target L.

Variations in purchase consideration

3.38 Where there is a choice as to the form in which consideration is received or paid, e.g. in cash or in shares, the Issuer will need to make an assumption as to the mix and state the assumption clearly in a note to the pro forma financial information.

3.39 In circumstances where the impact of a different mix of consideration could be significant, it may be necessary to present an extension to the pro forma financial information illustrating the potential impact of such different mix of consideration. This may be done either in a columnar presentation on the face of pro forma primary statements or in its notes.

3.40 To the extent that the consideration in a business combination is receivable in the future and is dependent on the outcome of future events, the Issuer needs to estimate the fair value of such contingent consideration in compiling the pro forma financial information and ensures that appropriate disclosure is made to investors where the contingent consideration is subject to significant changes.

Inter-company balances and transactions

3.41 An Issuer is required to eliminate the inter-company balances in preparing its consolidated financial statements under HKFRS10. As such, adjustments should be made to eliminate any inter-company balances and transactions between the Issuer and the target in the compilation of pro forma financial information of the enlarged group.

3.42 Where the target's information presented is based on a date that is not coterminous with the Issuer, the inter-company balances will likely not be the same and will relate to different transactions. Where accounting periods are not coterminous and inter-company balances cannot be eliminated in full, an Issuer should consider the general principles under HKFRS 10 in connection with the consolidation of a subsidiary which uses a different financial year end from the parent company and make adjustments as appropriate. In rare cases, it may be appropriate to perform a partial elimination such that they are stated net. In any event, the fact that the inter-company balances are different and the treatment adopted in presenting the pro forma financial information should be disclosed clearly in the notes to the pro forma financial information.

3.43 Similarly, where a pro forma statement of profit or loss (and cash flow statement) is presented and the inter-company transactions cannot be eliminated in full because of the non-coterminous year ends, the same approach as set out in section 3.42 above should be followed.

Foreign currency translation

3.44 Where the financial information of the acquiree is stated in a currency different from the presentation currency of the Issuer, such information has to be translated into the presentation currency of the Issuer. The rate applied would generally be the rate that would be applied under the Issuer's accounting policy for foreign currency translation.

Example 16

Company M issues a circular for the acquisition of Target N which constitutes a very substantial acquisition. Company M's presentation currency is HK$ while that for Target N is Euro. According to Company M's accounting policy, profit or loss of foreign subsidiaries are translated into HK$ using the average foreign exchange rate during the period, while statement of financial position items are translated using the closing rate on the statement of financial position date. In preparing the pro forma statement of profit or loss and the statement of financial position as at and for the year ended 31 December 20X2, Target N's statement of profit or loss is translated using the average Euro : HK$ exchange rate during the year, whereas statement of financial position items are translated using the closing rate on 31 December 20X2.

Synergy benefits

3.45 Acquisitions are often justified in terms of the synergies to be obtained, which are normally dependent on the future actions of the management of the enlarged group.

3.46 Consequently, synergies would not be the subject of adjustments made in deriving at pro forma financial information. The anticipated synergy effect is not adjusted as a pro forma adjustment but rather taken into account in the working capital forecast or disclosed elsewhere in the investment circular.

Additional financing required to settle the consideration for an acquisition

3.47 In some acquisitions, an Issuer needs to raise additional financing to settle the consideration for an acquisition. The Issuer should exercise caution in respect of whether an adjustment should be made to reflect the additional financing to be raised in the pro forma financial information.

3.48 Where the acquisition (the subject matter of the circular) is conditional on the raising of additional financing, these two transactions are an integral part of the whole transaction, and they are regarded inter-locking components of the transaction. In such case, the additional financing to be raised is normally reflected as an adjustment in the pro forma financial information and appropriate disclosure should be made in the note. See section 3.4 and Example 9 for more details.

3.49 Where the Issuer intends to settle the consideration of an acquisition by raising additional financing but the completion of the acquisition is not conditional on raising such additional financing, the acquisition and raising additional financing are not considered inter-locking transactions. In such case, the additional financing to be raised should not be reflected as an adjustment in the pro forma financial information because the subject matter of the circular is the acquisition.

Acquisition involving two target companies

3.50 In practice, it is not uncommon that an acquisition may involve two (or even more) target companies. Question often arises as to how many sets of pro forma financial information should be presented. It depends on whether the two acquisitions are linked. These acquisitions are normally considered to be linked if the acquisition of one target company is conditional on the acquisition of the other and shareholders cannot approve each acquisition separately.

3.51 If the acquisition of one target company is conditional on the acquisition of the other and the shareholders cannot approve each acquisition separately (i.e. the two acquisitions are linked), then one set of pro forma financial information presenting the acquisition of the two target companies at the same time shall be presented. In contrast, if the acquisition of one target company is not dependent on the acquisition of the other one and shareholders can approve each acquisition separately (i.e. the acquisitions are not linked), then at least two sets of pro forma financial information presenting the acquisitions of the two target companies separately shall be presented. In the latter situation, the Issuer can also voluntarily choose to present one more set of pro forma financial information to illustrate the impact of acquiring the two target companies at the same time provided that the two acquisitions are not mutually exclusive and the Issuer considers such scenario is possible.

Disposal of subsidiaries

3.52 As with the purchase price allocation and determination of goodwill described in sections 3.33 to 3.37 above, when a subsidiary is to be disposed of, any movement in the net asset value of the subsidiary subsequent to the date of the unadjusted information chosen for the purpose of presenting pro forma financial information is not taken into account in preparing the pro forma adjustments. The calculation of the estimated gain or loss on disposal is based on the date of the pro forma financial information and further note disclosures should be made indicating that the amount is likely to vary depending on the changes in net assets up to the date of completion of the disposal. If the amount can be quantified, this should be disclosed.

Rights issue

3.53 In a rights issue circular, shares issued after the statement of financial position date that are not related to the rights issue should not be adjusted in calculating pro forma net tangible assets. However, the additional shares issued should be disclosed in the notes to the pro forma financial information to make the pro forma financial information more meaningful and useful.

Example 17

Company Z has published audited financial statements for the year ended 31 Dec 20X2, showing 550 million outstanding shares and net tangible assets of $400 million. On 1 May 20X3, Company Z issued an additional 50 million shares for a consideration of $2 per share. At 31 May 20X3, Company Z's net tangible assets have increased to $550 million (due to proceeds from share issuance on 1 May 20X3 of $100 million and profits from January to May 20X3 of $50 million), and it proposes a rights issue to be completed in June 20X3 on a 1:2 basis based on outstanding shares on 31 May 20X3 (the "record date") and at an issuance price of $1.5 per share. Share and net tangible asset information of the company is as follows (assuming no transaction costs):

	31 Dec 20X2	**Issued shares on 1 May 20X3**	**31 May 20X3**	**Shares expected to be issued upon rights issue (in the ratio of 1:2)**
Number of shares ('million)	550	50	600	300
Net tangible assets ($'million)	$400	-	$550	-
Proceeds/ estimated proceeds from share issuance ($'million)	-	$100	-	$450

Company Z issues a circular on the proposed rights issue and discloses pro forma net tangible asset information as if the rights issue was completed on 31 Dec 20X2.

Pro forma net tangible assets
= Net tangible assets at 31 December 20X2 + Net proceeds from the rights issue
= $400 million + $450 million
= $850 million

Pro forma net tangible assets per share

$$= \frac{\text{Pro forma net tangible assets}}{\text{(Number of shares outstanding at 31 December 20X2 + Rights issue shares)}}$$

$$= \frac{\$850 \text{ million}}{(550 + 300) \text{ million}}$$

$$= \$1 \text{ per share}$$

The post 31 December 20X2 movements in share capital and net tangible assets as a result of the share issuance on 1 May 20X3 and other post statement of financial position events and transactions are not taken into account since they are not directly attributable to the rights issue in June 20X3 which is the subject matter of the circular. However, for the purposes of determining the estimated rights issue shares and the related estimated proceeds, the number of shares outstanding as at the "record date" (i.e. 600 million shares in this example) should be used.

This again follows the general principle that no adjustments are made in respect of subsequent events apart from those which meet the adjustment criteria. To ensure that the information presented is not misleading, the subsequent event of the issue of 50 million shares on 1 May 20X3 should be disclosed in a note to the pro forma financial information together with an explanation that the number of rights issue shares assumed in presenting pro forma net tangible assets per share is based on the actual number of shares in issue on the record date.

Pro forma adjustments – other practical issues

Tax

3.54 Tax effects of adjustments directly attributable to a transaction would generally have to be considered. In quantifying tax effects, an Issuer would look at the incremental impact on tax liabilities and assets using the Issuer's accounting policies for taxation rather than simply applying the Issuer's overall effective tax rate.

Transaction costs

3.55 An adjustment is made for costs that are directly attributable to a transaction and that do not relate to future events or decisions and are factually supportable.

Debt repayment

3.56 Where the transaction that is the subject of an Investment Circular is an issue of securities which will be used to repay debt, the Issuer has to consider whether the repayment of debt should be reflected as a pro forma adjustment.

3.57 Repayment of debt should be reflected as a pro forma adjustment if the proceeds of the issue are allocated to the repayment of debt instruments on the basis of commitments stated in the Investment Circular or legal agreements. However, where there are no stated commitments (i.e. the repayment of debt is not an interlocking component of the transaction), the repayment of debt would not be considered directly attributable to the transaction. In these circumstances, no consequential adjustment would be made to reduce debt balances or interest costs in the pro forma financial information.

Section 4

Presentation and disclosures

4.1 In making a judgement on whether pro forma financial information as a whole is misleading, an Issuer considers the pro forma financial information as a whole whilst having regard to each of the following components of information:

(a) The introductory narrative explaining the purpose and nature of the pro forma financial information;

(b) The statements, formats and captions selected for presentation;

(c) The unadjusted information about the Issuer and whether it is audited or unaudited;

(d) The adjustments;

(e) The pro forma totals; and

(f) The notes explaining the source of information, the adjustments and the assumptions underlying the basis of preparation.

Illustrative disclosures reflecting the above requirements are shown in the Appendix.

Purpose and nature of information

4.2 Pro forma financial information must clearly state:

(a) The purpose for which it has been prepared;

(b) That it is prepared for illustrative purposes only; and

(c) That because of its nature, it may not give a true picture of the Issuer's financial position or results.

4.3 The generic purpose of pro forma financial information is to illustrate the effects of the transaction on certain unadjusted financial information or aspects of that information. It should therefore clearly identify the specific transactions and the unadjusted financial information involved.

Notes to the pro forma financial information

4.4 In addition to the purpose and nature of pro forma financial information (see sections 4.2 and 4.3), disclosures to accompany pro forma financial information typically include:

(a) The basis upon which the pro forma financial information is prepared;

(b) The source from which the unadjusted financial information has been extracted, and whether or not an audit or review report on such a source has been published;

(c) Description and explanation of each pro forma adjustment. For acquiree or divestee financial information, this includes the source from which such information has been extracted and whether or not an audit or review report on such a source has been published;

(d) If not publicly available, a description of the applicable criteria on the basis on which the pro forma financial information has been compiled; and

(e) A statement to the effect that the pro forma financial information has been compiled for illustrative purposes only and that, because of its nature, it does not represent the entity's actual financial position, financial performance, or cash flows.

4.5 It is recommended practice to draw attention to the approach taken with regard to subsequent events by making a disclosure to the effect that the pro forma financial information does not take into account any trading or other transactions subsequent to the date of the financial statements included in the pro forma financial information.

4.6 As described in section 3.7 of this publication, disclosures of subsequent events may also be required to prevent the pro forma financial information from being misleading.

4.7 Issuers are encouraged to consider including explanatory supplementary notes together with available quantitative data to explain the pro forma amounts shown. The key objective is that the pro forma financial information shows the impact of the relevant transaction and that the information is useful to assist investors to decide on whether or not to proceed with an investment decision.

Section 5

Reporting by reporting accountants

Role of the reporting accountants

5.1 Pro forma financial information that is used to comply with the requirements of the Exchange must be reported on by the reporting accountants who must report that, in their opinion:

(a) the pro forma financial information has been properly compiled on the basis stated;

(b) such basis is consistent with the accounting policies of the Issuer; and

(c) the adjustments are appropriate for the purpose of the pro forma financial information as disclosed pursuant to MBLR 4.29(1) or GEMLR 7.31(1).

5.2 As noted in section 1.2, preparation of pro forma financial information in accordance with AG 7 is the responsibility of the directors of the Issuer. The reporting accountants have no responsibility to compile such information. Their responsibility is to report on whether the pro forma financial information has been compiled, in all material respects, by the Issuer on the basis of the applicable criteria, including the statements specifically required by MBLR 4.29 or GEMLR 7.31. When reporting in accordance with HKSAE 3420 and the Listing Rules, reporting accountants are required to comply with independence and other requirements of the HKICPA's Code of Ethics for Professional Accountants and implement quality control procedures that are applicable to the individual engagement.

5.3 A reasonable assurance engagement under HKSAE 3420 involves performing procedures to assess whether the applicable criteria used in the compilation of pro forma financial information provide a reasonable basis for presenting the significant effects directly attributable to a transaction and to obtain sufficient appropriate evidence about whether the related pro forma adjustments give appropriate effect to the criteria; and the resulting pro forma column reflects the proper application of those adjustments to the unadjusted financial information.

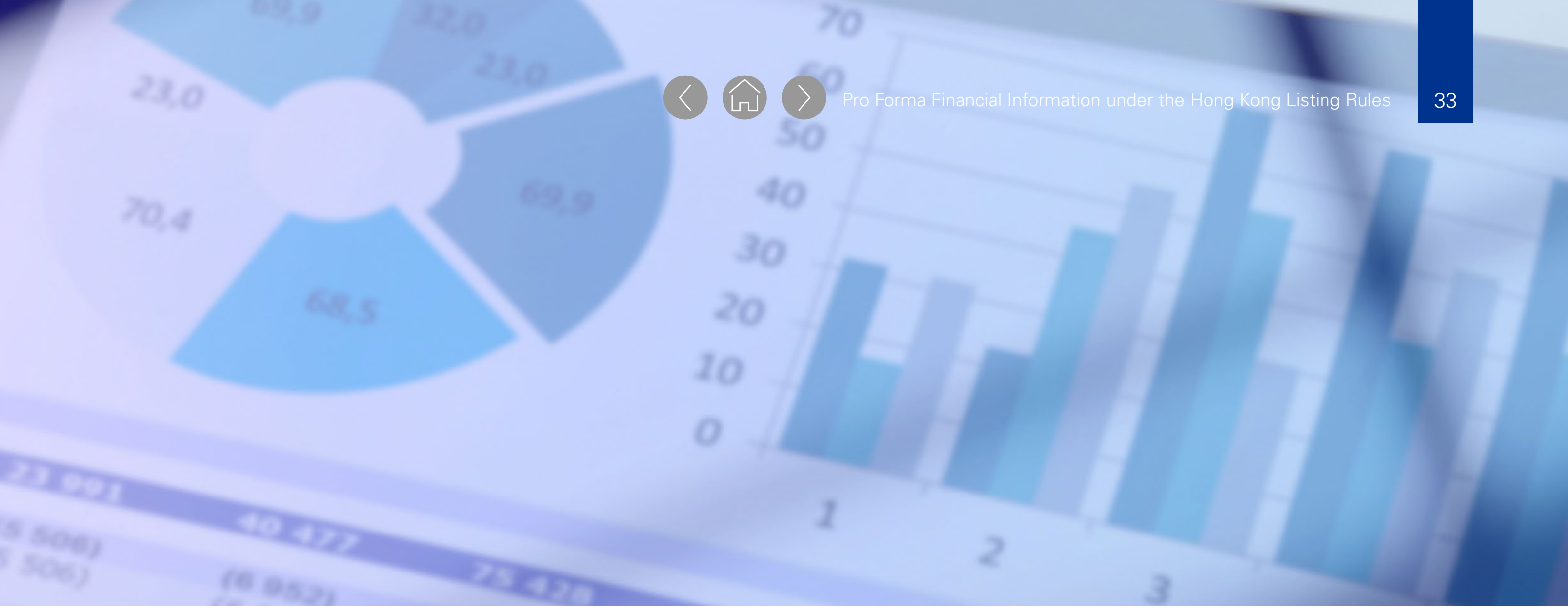
5.4 The reporting accountants also evaluate the overall presentation of the pro forma financial information.

5.5 The reporting accountants assess whether the unadjusted financial information has been extracted from an appropriate source. They also opine on whether the pro forma adjustments are directly attributable to the event or transaction, factually supportable, and consistent with the Issuer's accounting policies.

5.6 As far as the presentation of the pro forma financial information is concerned, the reporting accountants consider the overall presentation and structure of the pro forma financial information; whether the information and explanatory notes illustrate the impact of the transaction in a manner that is not misleading; whether appropriate disclosures are provided to enable intended users to understand the information conveyed; and whether the reporting accountants have become aware of any subsequent events which may require reference to or disclosure in pro forma financial information.

Assurance report

5.7 The reporting accountants' report includes their opinion on whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria. The report follows the requirements of the Listing Rules when prepared in order to meet Exchange requirements.



5.8 The assurance report also includes other information such as the reporting accountants' responsibilities, the nature of reasonable assurance engagement, judgement involved in selecting procedures performed, etc.

5.9 In some circumstances, the reporting accountants may consider it necessary to draw users' attention to a matter which is of such importance that it is fundamental to a user's understanding of the pro forma financial information, even though the pro forma financial information has been compiled on the basis of the applicable criteria. In such circumstances, the reporting accountants shall include an emphasis of matter paragraph in their report.

5.10 Where there is a limitation on the scope of the work of the reporting accountants, or the reporting accountants are of the view that the pro forma financial information has not been compiled on the basis of the applicable criteria, and the effect of the matter is or may be material, the reporting accountants would consider expressing a qualified conclusion, adverse conclusion or disclaimer of conclusion, depending on the facts and circumstances of a particular case.

APPENDIX

Example disclosures on pro forma financial information

Illustration 1 – Pro forma statement of adjusted net tangible assets and pro forma forecast basic earnings per share in an IPO prospectus

A. Unaudited Pro Forma Statement of Adjusted Net Tangible Assets

The following unaudited pro forma statement of adjusted net tangible assets of Company A and its subsidiaries (the "Group") is prepared in accordance with Rule 4.29 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited and is set out below to illustrate the effect of the public offering by Company A of its shares (the "Offering") on the consolidated net tangible assets attributable to the equity owners of Company A as of 31 December 20X2 as if the Offering had taken place on 31 December 20X2.

This unaudited pro forma statement of adjusted net tangible assets has been prepared for illustrative purposes only and because of its hypothetical nature, it may not give a true picture of the financial position of the Group had the Offering been completed as of 31 December 20X2 or at any future date.

	Consolidated net tangible assets attributable to the equity owners of Company A as of 31 December 20X2(1)	Estimated net proceeds from the Offering(2) (4)	Pro forma adjusted net tangible assets	Pro forma adjusted net tangible assets per share(3) (4)	
	RMB'million	*RMB'million*	*RMB'million*	*RMB*	*HK$*
Based on an offer price of HK$1.20 per share	785	110	895	1.79	2.15
Based on an offer price of HK$1.44 per share	785	135	920	1.84	2.21

Notes:

(1) The consolidated net tangible assets attributable to equity owners of Company A as of 31 December 20X2 is arrived at after (i) deducting goodwill of RMB50 million and intangible assets of RMB70 million; and (ii) adjusting the share of intangible assets attributable to non-controlling interests of RMB5 million from the consolidated total equity attributable to the equity owners of Company A of RMB900 million as of 31 December 20X2, which is extracted from the Accountants' Report set out in Appendix I to the Prospectus.

(2) The estimated net proceeds from the Offering are based on the offer prices of HK$1.20 and HK$1.44 per share, being the lower end price and higher end price of the indicative offer price range respectively, and the issuance of 125,000,000 shares, after deduction of the underwriting fees and other related expenses paid or payable by Company A (excluding the listing expenses charged to profit or loss during the Track Record Period) and do not take into account any shares which may be issued upon the exercise of the over-allotment option and the options granted under the pre-IPO share option scheme of Company A.

(3) The pro forma adjusted net tangible assets per share are arrived at after the adjustments referred to in the preceding paragraphs and on the basis that 500,000,000 shares are expected to be in issue immediately following the Offering (including 125,000,000 shares newly issued upon the IPO), but do not take into account any shares which may be issued upon the exercise of the over-allotment option and the options granted under the pre-IPO share option scheme of Company A.

(4) The estimated net proceeds from the Offering and the unaudited pro forma adjusted net tangible assets per share are converted from or into Hong Kong dollars (the "HK$) at an exchange rate of RMB1 to HK$1.20. No representation is made that HK$ amounts have been, could have been or may be converted into RMB, or vice versa, at that rate.

(5) The Group's property interests as at 30 April 20X3 have been valued by Valuer X, an independent property valuer and consultant. The above pro forma statement of adjusted net tangible assets does not take into account the surplus arising from the revaluation of the Group's property interests amounting to approximately RMB200 million. Revaluation surplus has not been recorded in the historical financial information of the Group and will not be recorded in the consolidated financial statements of the Group in future periods as the Group's property, plant and equipment are stated at cost less accumulated depreciation and impairment losses, if any. If the revaluation surplus were recorded in the Group's consolidated financial statements, additional annual depreciation of approximately RMB7 million would be charged against the profit in future periods.

(6) No adjustment has been made to reflect any trading result or other transactions of the Group entered into subsequent to 31 December 20X2, including but not limited to the dividends of RMB50 million declared on 31 January 20X3. Had such dividends been declared on 31 December 20X2, the pro forma adjusted net tangible assets would have decreased by approximately by RMB50 million and the pro forma adjusted net tangible assets per share would have decreased by approximately RMB0.1 (equivalent to HK$0.12).

B. Unaudited Pro Forma Forecast Basic Earnings per Share

The following pro forma forecast basic earnings per share for the year ending 31 December 20X3 has been prepared on the basis of the notes set out below for the purpose of illustrating the effect of the Offering by Company A as if it had taken place on 1 January 20X3. The pro forma forecast basic earnings per share has been prepared for illustrative purposes only and, because of its hypothetical nature, it may not give a true picture of the financial results of the Group for the year ending 31 December 20X3 or for any future period.

Forecast consolidated profit attributable to the equity owners of Company A for the year ending 31 December 20X3[(1)]	not less than RMB80 million
Unaudited pro forma forecast basic earnings per share[(2)]	not less than RMB0.16

Notes:

(1) The bases and assumptions on which the above profit forecast has been prepared are set out in Appendix III to the prospectus. The directors have prepared the forecast consolidated profit attributable to the equity owners of Company A for the year ending 31 December 20X3 based on the actual consolidated results for the four months ended 30 April 20X3 and the forecast consolidated results for the remaining eight months ending 31 December 20X3.

(2) The calculation of the unaudited pro forma forecast basic earnings per share is based on the forecast consolidated profit attributable to the equity owners of Company A for the year ending 31 December 20X3, assuming that a total of 500,000,000 shares had been in issue throughout the period. The calculation of the unaudited pro forma forecast basic earnings per share does not take into account any shares which may be issued upon the exercise of the over-allotment option and the options granted under the pre-IPO share option scheme of Company A.

Illustration 2 – Pro forma financial information in the Circular of Company B in connection with the acquisition of certain Target Assets which constitutes a major transaction

A. Introduction to the pro forma financial information

The following is the unaudited pro forma consolidated statement of assets and liabilities of Company B as if the acquisition of Company Y (the "Acquisition") had been completed on 31 December 20X2, and is based on the consolidated statement of financial position of Company B as extracted from the consolidated financial statements of Company B for the year ended 31 December 20X2 as set out in the company's 20X2 annual report after giving effect to the pro forma adjustments described in the notes.

The pro forma financial information of Company B is based on a number of assumptions, estimates and uncertainties. Among other key assumptions, the directors of Company B have assumed that the company would be able to raise sufficient funding through internal resources, bank borrowings and/or external financing to finance the Acquisition.

The unaudited pro forma consolidated statement of assets and liabilities has been prepared by the directors in accordance with Rules 4.29 and 14.67(6)(a)(ii) of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited, for the purposes of illustrating the effect of the Acquisition only and, because of its hypothetical nature, it may not give a true picture of the financial position of Company B after the Acquisition had the Acquisition been completed on 31 December 20X2 or any future date.

B. Unaudited pro forma consolidated statement of assets and liabilities of Company B as at 31 December 20X2

	Consolidated statement of assets and liabilities	Pro forma adjustments		Pro forma consolidated statement of assets and liabilities
	$'million	*$'million (Note 1)*	*$' million (Note 2)*	*$'million*
Non-current assets				
Property, plant and equipment	366	200	53	619
Construction in progress	252	-	-	252
Goodwill	155	-	-	155
Intangible assets	43	-	-	43
Deferred tax assets	20	-	-	20
Other assets	12	-	-	12
	848			**1,101**

B. Unaudited pro forma consolidated statement of assets and liabilities of Company B as at 31 December 20X2 (Continued)

	Consolidated statement of assets and liabilities	Pro forma adjustments		Pro forma consolidated statement of assets and liabilities
	$'million	*$'million (Note 1)*	*$' million (Note 2)*	*$'million*
Current assets				
Inventories	599	-	-	599
Income tax recoverable	55	-	-	55
Trade receivable, net	333	-	-	333
Other receivables	47	5	-	52
Time deposits with original maturity over three months	30	-	-	30
Cash and cash equivalents	727	30	(280)	477
	1,791			**1,546**
Current liabilities				
Current portion of long-term debt	50	-	-	50
Trade payable	231	-	-	231
Accrued expenses and other payables	41	8	-	49
Income tax payable	89	-	-	89
	411			**419**
Net current assets	**1,380**			**1,127**
Total assets less current liabilities	**2,228**			**2,228**
Non-current liabilities				
Long-term debt	20	-	-	20
Deferred tax liabilities	13	-	-	13
	33			**33**
NET ASSETS	**2,195**			**2,195**

Notes:

(1) The adjustments represent the unadjusted financial information of Company Y as at 31 December 20X2, as extracted from the Accountants' Report set out in Appendix II to this Circular.

(2) Pursuant to the purchase and sales agreement, the total consideration for the Acquisition is $280 million, which is to be satisfied in cash. Company Y is a company established to hold a piece of land and has not commenced any significant business operations other than holding the land. Therefore, the Acquisition is not accounted for as a business combination as defined in Hong Kong Financial Reporting Standard 3 Business Combination but as an asset acquisition. The cost of acquisition is allocated between the individual identifiable assets and liabilities of Company Y based on their relative fair values at the acquisition date and, for the purpose of this pro forma financial information, the fair values as at 31 December 20X2. The fair values of the identifiable assets and liabilities of Company Y are subject to change upon the completion of the Acquisition. Consequently, the actual allocation of the cost of acquisition at the acquisition date will likely result in different amounts from those stated in this pro forma financial information. The pro forma adjustments made represent:

(i) the fair value adjustments of $53 million on property, plant and equipment; and

(ii) the payment of cash consideration of $280 million.

(3) No adjustment has been made to the pro forma financial information for acquisition-related costs (including fees to legal advisers, financial adviser, reporting accountants, valuer, printer and other expenses) as the directors determined that such costs are insignificant.

(4) No adjustment has been made to reflect any trading results or other transactions of the Group entered into subsequent to 31 December 20X2.

Illustration 3 – Pro forma financial information in the Circular of Company C in connection with the acquisition of an 80% interest in Company S which constitutes a very substantial acquisition

A. Introduction to the pro forma financial information

The following is the pro forma financial information of Company C as if its acquisition of the 80% equity interest in Company S ("the Acquisition") had been completed on 31 December 20X2 for the pro forma consolidated statement of financial position and at the beginning of the year ended 31 December 20X2 for the pro forma consolidated statement of profit or loss and pro forma consolidated cash flow statement. The pro forma financial information of Company C is based upon the consolidated financial statements of Company C for the year ended 31 December 20X2 as set out in the company's 20X2 annual report and the financial information of Company S as set out in the accountants' report in Appendix II to this Circular, and adjusted to reflect the effect of the Acquisition.

The pro forma financial information of Company C is based on a number of assumptions, estimates and uncertainties. Among other key assumptions, the directors of Company C have assumed that the company would be able to raise sufficient funding through internal resources, bank borrowings and/or external financing to finance the Acquisition.

The pro forma financial information of Company C has been prepared by the directors of Company C in accordance with Rules 4.29 and 14.69(4)(a)(ii) of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited, for the purposes of illustrating the effect of the Acquisition only and because of its hypothetical nature, it may not give a true picture of the financial position or results of Company C had the Acquisition been completed as of the specified dates or any future date.

B. Unaudited pro forma consolidated statement of financial position as at 31 December 20X2

	Company C	**Pro forma adjustments**		**The enlarged group**
	$'million	*$'million (Note 1)*	*$'million (Notes 2, 3(i))*	*$'million*
Non-current assets				
Investment properties	349	-	-	349
Other property, plant and equipment	378	100	10	488
Goodwill	72	-	22	94
Other financial assets	23	-	-	23
Deferred tax assets	26	3	-	29
	848			**983**
Current assets				
Inventories	244	2,004	110	2,358
Trade and other receivables	81	1	-	82
Cash and cash equivalents	502	3	(400)	105
	827			**2,545**

B. Unaudited pro forma consolidated statement of financial position as at 31 December 20X2 (Continued)

	Company C	Pro forma adjustments		The enlarged group
	$'million	*$'million (Note 1)*	*$'million (Notes 2, 3(i))*	*$'million*
Current liabilities				
Trade and other payables	680	121	-	801
Bank borrowings	25	580	-	605
Tax payable	34	-	-	34
	739			**1,440**
Net current assets	**88**			**1,105**
Total assets less current liabilities	**936**			**2,088**
Non-current liabilities				
Bank borrowings	304	1,022	-	1,326
Deferred tax liabilities	14	-	36	50
	318			1,376
NET ASSETS	**618**			**712**
CAPITAL AND RESERVES				
Share capital	13	-	-	13
Reserves	413	-	-	413
Total equity attributable to equity shareholders of the Company	**426**			**426**
Non-controlling interests	**192**	**-**	**94**	**286**
TOTAL EQUITY	**618**			**712**

C. Pro forma consolidated statement of profit or loss for the year ended 31 December 20X2

	Company C	Pro forma adjustments			The enlarged group
	$'million	*$'million (Note 1)*	*$'million (Note 3(ii))*	*$'million (Note 3(iii))*	*$'million*
Revenue	691	400	-	-	1,091
Cost of sales	(482)	(300)	-	-	(782)
Gross profit	**209**				**309**
Other revenue	13	-	-	-	13
Other net income	6	-	-	-	6
Distribution costs	(43)	(21)	-	-	(64)
Administrative expenses	(34)	(50)	(1)	-	(85)
Other operating expenses	(4)	-	-	-	(4)
Profit from operations	**147**				**175**
Finance costs	(15)	-	-	-	(15)
Profit before taxation	132				160
Income tax	(63)	(9)	-	-	(72)
Profit for the year	**69**				**88**
Attributable to:					
Equity shareholders of the Company	57	20	(1)	(4)	72
Non-controlling interests	12	-	-	4	16
Profit for the year	**69**				**88**

D. Pro forma consolidated cash flow statement for the year ended 31 December 20X2

	Company C	Pro forma adjustments			The enlarged group
	$'million	*$'million (Note 1)*	*$'million (Note 2)*	*$'million (Note 3(ii))*	*$'million*
Operating activities					
Profit before taxation	132	29	-	(1)	160
Depreciation	45	10	-	1	56
Interest income	(3)	-	-	-	(3)
Gain on sale of other property, plant and equipment	(1)	-	-	-	(1)
Interest expense	15	-	-	-	15
Equity settled share-based payment expenses	2	-	-	-	2
	190				229
Changes in working capital					
Increase in inventories	(107)	(1,204)	-	-	(1,311)
Increase in trade and other receivables	(27)	(1)	-	-	(28)
Increase in trade and other payables	122	98	-	-	220
Cash generated from/(used in) operations	**178**				**(890)**
Tax paid	(65)	-	-	-	(65)
Interest paid	(15)	-	-	-	(15)
Net cash generated from/(used in) operating activities	**98**				**(970)**

D. Pro forma consolidated cash flow statement for the year ended 31 December 20X2 (Continued)

	Company C	Pro forma adjustments			The enlarged group
	$'million	*$'million (Note 1)*	*$'million (Note 2)*	*$'million (Note 3(ii))*	*$'million*
Investing activities					
Payment for purchase of other property, plant and equipment	(78)	(53)	-	-	(131)
Payment for acquisition of subsidiary, net of cash of the subsidiary acquired	-	-	(398)	-	(398)
Proceeds from disposal of other property, plant and equipment	3	-	-	-	3
Interest received	3	-	-	-	3
Net cash used in investing activities	**(72)**				**(523)**
Financing activities					
Proceeds from bank borrowings	41	1,122	-	-	1,163
Dividends paid to the equity shareholders of the Company	(4)	-	-	-	(4)
Dividends paid to non-controlling interests	(6)	-	-	-	(6)
Repayment of borrowings	(119)	-	-	-	(119)
Net cash (used in)/ generated from financing activities	**(88)**				**1,034**
Net decrease in cash and cash equivalents	(62)				(459)
Cash and cash equivalents at 1 January	562	2	(2)	-	562
Effect of foreign exchange rate changes	2	-	-	-	2
Cash and cash equivalents at 31 December	**502**				**105**

Notes:

(1) *The adjustments represent historical financial information of Company S as at and for the year ended 31 December 20X2, as extracted from the accountants' report in Appendix II to this Circular.*

(2) *The adjustments represent the payment of the consideration for the Acquisition, which amounts to $400 million to be satisfied in cash, pursuant to the sale and purchase agreement.*

(3) *The identifiable assets and liabilities of Company S acquired by Company C will be accounted for in the consolidated financial statements of the enlarged group at fair value under the purchase method of accounting in accordance with Hong Kong Financial Reporting Standard 3 (Revised), Business Combinations.*

For the purposes of the pro forma financial information, the allocation of the purchase price is determined based on the directors' estimates of the fair value of the identifiable assets and liabilities of Company S which existed as at 31 December 20X2.

The amounts of goodwill and fair values of the identifiable assets and liabilities of Company S are subject to change upon the completion of the valuation of the fair values of the identifiable assets and liabilities of Company S on the date of completion of the Acquisition. Consequently, the resulting goodwill, the actual allocation of the purchase price and the resulting non-controlling interest at the date of completion, and depreciation for subsequent periods, will likely result in different amounts than those stated in this pro forma financial information.

Pro forma adjustments made represent:

(i) *The recognition of:*

- *fair value adjustments of $10 million on other property, plant and equipment, and $110 million on properties under development held by Company S.*
- *recognition of non-controlling interests of $94 million and goodwill of $22 million being the excess of the purchase consideration over Company C's share of the fair value of the net identifiable assets of Company S.*

	$'million	$'million
Fair value of consideration		400
Net assets acquired:		
Net assets value of Company S as at 31 December 20X2	388	
Fair value adjustments on other property, plant and equipment	10	
Fair value adjustments on properties under development	110	
Effect of deferred tax liabilities estimated at corporate income tax rate of 25% and land appreciation tax rate of 5%	(36)	
Total net assets acquired	472	
20% non-controlling interests in Company S	(94)	
Identified assets acquired and liabilities assumed		378
Goodwill arising on acquisition		22

(ii) *The annual additional depreciation of approximately $1 million arising from the fair value adjustments to other property, plant and equipment on a straight-line basis over the estimated useful lives of 10 years. Reversal of the corresponding deferred tax liabilities is insignificant. The adjustments are expected to have a continuing effect on the enlarged group.*

(iii) *Non-controlling interests' share of Company S's profit for the year. This adjustment is expected to have a continuing effect on the enlarged group's consolidated statement of profit or loss.*

	$'million
Profit of Company S after adjusting for items in (ii) above	19
Profit shared by the 20% non-controlling interests	4

(4) *No adjustment has been made to the pro forma financial information for acquisition-related costs (including fees to legal advisers, financial adviser, reporting accountants, valuer, printer and other expenses) as the directors determined that such costs are insignificant.*

(5) *No adjustment has been made to the pro forma financial information to reflect any trading results or other transactions of the enlarged group entered into subsequent to 31 December 20X2.*

Illustration 4 – Pro forma financial information in the Circular of Company D in connection with the disposal of one of its operating segments (“the Target Assets”) which constitutes a very substantial disposal

A. Introduction to the pro forma financial information

The pro forma financial information presented below is prepared to illustrate (i) the financial position of the Remaining Group as if the disposal of the Target Assets (“the Disposal”) had been completed on 31 December 20X2; and (ii) the results and cash flows of the Remaining Group for the year ended 31 December 20X2 as if the Disposal had been completed on 1 January 20X2. The pro forma financial information of Company D is prepared based on the consolidated financial statements of Company D as set out in the company’s 20X2 annual report, after giving effect to the pro forma adjustments described in the notes.

The pro forma financial information has been prepared by the directors of Company D in accordance with Rules 4.29 and 14.68(2)(a)(ii) of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited, for the purposes of illustrating the effect of the Disposal only, and because of its hypothetical nature, it may not give a true picture of the financial position or results of the Remaining Group had the Disposal been completed as of the specified dates or any future date.

B. Pro forma consolidated statement of financial position of the Remaining Group as at 31 December 20X2

	The Group	**Pro forma adjustments**	**The Remaining Group**
	$’million	*$’million (Note 1)*	*$’million*
Non-current assets			
Property, plant and equipment	461	-	461
Interests in jointly controlled entities	3	-	3
Interests in associates	10	-	10
Other financial assets	61	-	61
	535		535
Current assets			
Inventories	39	-	39
Trade receivables	17	-	17
Prepayments, deposits and other receivable	97	-	97
Cash and cash equivalents	246	300	546
	399		699
Assets of disposal group classified as held for sale	434	(434)	-
	833		**699**
Current Liabilities			
Trade payables	92	-	92
Other payables and accruals	72	-	72
Tax payables	25	-	25
	189		189
Liabilities of disposal group classified as held for sale	190	(190)	-
	379		**189**
Net current assets	**454**		**510**
Total assets less current liabilities	**989**		**1,045**

B. Pro forma consolidated statement of financial position of the Remaining Group as at 31 December 20X2 (Continued)

	The Group	Pro forma adjustments	The Remaining Group
	$'million	*$'million (Note 1)*	*$'million*
Non-current liabilities			
Deferred income tax liabilities	1	-	1
Net assets	**988**		**1,044**
Capital and reserves			
Share capital	234	-	234
Reserves	754	56	810
	988		**1,044**

C. Pro forma consolidated statement of profit or loss of the Remaining Group for the year ended 31 December 20X2

	The Group	Pro forma adjustments		The Remaining Group
	$'million	*$'million (Note 2)*	*$'million (Note 3)*	*$'million*
Revenue	1,085	(434)	-	651
Cost of inventories consumed	(397)	159	-	(238)
Gross profit	688			413
Other income	5	(2)	94	97
Selling and distribution costs	(505)	202	-	(303)
Administrative expenses	(65)	26	-	(39)
Other operating expenses	(1)	1	-	-
Profit from operations	122			168
Share of loss of jointly controlled entities	(1)	-	-	(1)
Share of loss of associates	(4)	2	-	(2)
Profit before taxation	117			165
Income tax expenses	(19)	8	-	(11)
Profit for the year	**98**			**154**

D. Pro forma consolidated cash flow statement of the Remaining Group for the year ended 31 December 20X2

	The Group	Pro forma adjustments		The Remaining Group
	$'million	*$'million (Note 2)*	*$'million (Note 4)*	*$'million*
Cash flow from operating activities				
Cash generated from operations	126	(49)	-	77
Tax paid	(20)	8	-	(12)
Net cash generated from operating activities	106			65
Cash flows from investing activities				
Purchase of property, plant and equipment	(3)	3	-	-
Acquisition of jointly controlled entities	(1)	-	-	(1)
Acquisition of an associate	(1)	-	-	(1)
Proceeds from the Disposal, net of cash disposed of	-	-	280	280
Interest received	1	-	-	1
Net cash (used in)/generated from investing activities	(4)			279
Cash flows from financing activities				
Dividends paid to equity holders of the Company	(23)	-	-	(23)
Net cash used in financing activities	(23)			(23)
Net increase in cash and cash equivalents	79			321
Cash and cash equivalents at beginning of the year	225	-	-	225
Cash and cash equivalents at end of the year	304			546

Notes:

(1) *The adjustments represent the exclusion of the assets and liabilities of the Target Assets and the receipt of cash as if the Disposal had been completed on 31 December 20X2.*

	$'million
Consideration for the Disposal	300
Carrying amount of the Target Assets as at 31 December 20X2	(244)
Estimated gain on disposal	56

(2) *The adjustments represent the exclusion of the results and cash flows of the Target Assets for the year ended 31 December 20X2 as if the Disposal had been completed on 1 January 20X2. The amounts are extracted from the financial information of the Target Assets for the year ended 31 December 20X2.*

(3) *The adjustments reflect the gain on disposal of the Target Assets as if the Disposal had been completed on 1 January 20X2.*

	$'million
Consideration for the Disposal	300
Carrying amount of the Target Assets as at 1 January 20X2	(206)
Estimated gain on disposal	94

The estimated gain on disposal of the Target Assets represents the difference between the consideration for the Disposal and the carrying amount of the Target Assets as at 1 January 20X2.

The reconciliation of the carrying amount of the Target Assets is shown below:

	$'million
Net carrying amount of the Target Assets at 31 December 20X2	244
Net profit arising from the Target Assets for the year ended 31 December 20X2	(38)
Net carrying amount of the Target Assets as at 1 January 20X2	206

(4) *The adjustments reflect the net cash inflow as if the Disposal had been completed on 1 January 20X2:*

	$'million
Consideration for the disposal	300
Cash and cash equivalents held by the Target Assets as at 1 January 20X2	(20)
Net proceeds from the Disposal, net of cash disposed of	280

(5) *The adjustments in respect of the pro forma consolidated statement of profit or loss and cash flow statement above are not expected to have a continuing effect on the Remaining Group.*

(6) *The estimated gain on disposal of the Target Assets and net proceeds from the Disposal as illustrated notes (1), (3) and (4) are subject to change on the date of completion of the Disposal. The actual carry amount of the Target Assets, cash and cash equivalents held by the Target Assets and thus the gain/loss on disposal and net proceeds from the Disposal at the date of completion will likely be different from those stated in the pro forma financial information.*

(7) *No adjustment has been made to the pro forma financial information for disposal-related costs (including fees to legal advisers, financial adviser, reporting accountants, valuer, printer and other expenses) as the directors determined that such costs are insignificant.*

(8) *No adjustment has been made to reflect any trading results or other transaction of the Group entered subsequent to 31 December 20X2.*

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