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CLIENT BRIEFING

MARCH 2023

HONG KONG STOCK EXCHANGE LAUNCHES NEW LISTING REGIME FOR "SPECIALIST TECHNOLOGY COMPANIES"

Summary

The much awaited consultation conclusions on the new specialist technology companies regime (Chapter 18C) has been issued by The Hong Kong Stock Exchange (the **Exchange**) today. The regime will allow the listing of certain tech companies (termed **Specialist Technology Companies**) that do not yet satisfy the existing Main Board's financial track record requirements. The changes will come into effect on 31 March 2023, opening the door for companies (including those looking at a dual primary or secondary listing[1]) which do not yet meet the current profit or HK$500 million revenue thresholds - from sectors including AI, robotics, semiconductors, electric vehicles, green tech and new food tech - to list on the Main Board and raise funds from both retail and institutional investors.

Key changes

The initial consultation was issued in October 2022, and a significant portion of the consultation feedback welcomed the introduction of the new regime. However, concerns were raised by some respondents that certain of the proposed safeguards were too onerous and could compromise the competitiveness of the new regime. The consultation conclusions reflect some adjustments which will be welcomed by the market as a result. In particular:

- **Market capitalisation:** The Exchange had initially proposed that to qualify for listing, Specialist Technology Companies should have a minimum expected market capitalisation of HK$15 billion (for companies yet to reach a HK$250 million revenue threshold) and HK$8 billion (for those that have). This is significantly higher than for the existing pre-revenue biotech regime (under Chapter 18A) as unlike Chapter 18A applicants, there would be no governmental authority that would be able to provide a comparable level of authority and regulatory oversight. Accordingly, the proposed qualification requirements are more heavily reliant on market validation as a safeguard for investors.

  However, various market participants considered these thresholds were too high and could compromise the viability of the new regime - some noted the proposed threshold represented a price-to-sales ratio of 32 times (compared to about 16 times for the Shanghai STAR market), which is difficult to achieve in the current market.

  The Exchange has taken these considerations on board and reduced the minimum market capitalisation to HK$10 billion for Commercial Companies and HK$6 billion for Pre-Commercial Companies.

- **R&D expenditure ratio:** The proposed 50% R&D expenditure threshold for Pre-Commercial Companies did not receive majority support, as it was thought to be too high and would exclude too many applicants. **Therefore, the Exchange has set an alternative threshold of 30% for those applicants that have already generated HK$150 million or more (but less than HK$250 million) revenue for the most recent audited financial year. Pre-Commercial Companies with revenue of less than HK$150 million for the most recent audited financial year will continue to be subject to the 50% threshold.**

  In addition, to cater for potential fluctuations in overall R&D and operating expenditure during the track record period, **the Exchange has modified the period of application of the ratio such that Specialist Technology Companies are required to meet the applicable percentage threshold: (1) on a yearly basis for at least two of the three financial years prior to listing; and (2) on an aggregate basis over all three financial years prior to listing.**

- **Investments from Pathfinder SIIs:** Comments were raised that the requirement for at least two sophisticated independent investors (**SII**s) each holding 5% at time of listing and for the prior 12 months was too difficult to achieve for many applicants**. The Exchange has revised the indicative benchmark to provide for more flexibility, i.e., investments from a group of two to five SIIs (each having invested in the listing applicant at least 12 months before the date of the listing application) (Pathfinder SIIs) that satisfy the following:**

[1] Subject to the relevant issuer meeting the dual primary or secondary listing requirements under Chapter 19 or Chapter 19C.

(a) **such investors in aggregate, (1) hold such amount of shares or convertible securities equivalent to 10% or more of the issued share capital of the listing applicant as at the date of its listing application and throughout the pre-application 12-month period; or (2) have otherwise invested an aggregate sum of at least HK$1.5 billion in the shares or convertible securities of the applicant at least 12 months prior to the listing application (excluding any subsequent divestments made on or before the listing application); and**

(b) **at least two such investors (1) each hold such amount of shares or convertible securities equivalent to 3% or more of the issued share capital of the listing applicant as at the date of its listing application and throughout the pre-application 12-month period; or (2) each have otherwise invested at least HK$450 million in the shares or convertible securities of the applicant at least 12 months prior to the listing application (excluding any subsequent divestments made on or before the listing application).**

- **Independent Price Setting Investors:** To address respondents' comments, the Exchange has revisited the types of independent investors that will be taken into account for the requirement of minimum allocation of the shares offered in an IPO to help ensure a robust IPO price discovery process for Specialist Technology Companies. **A new defined term, "Independent Price Setting Investors", is used to define such investors, which will comprise (i) independent Institutional Professional Investors (as contemplated in the Consultation Paper); and (ii) other types of independent investors with AUM, fund size or investment portfolio size of at least HK$1 billion.**

We set out below the key features of the regime as concluded by the Exchange.

Specialist Technology Companies

A Specialist Technology Company must primarily engage in the R&D and commercialisation of products / services to which science and/or technology are applied and which fall within an acceptable sector of a "Specialist Technology Industry". The Specialist Technology Industries and acceptable sectors are:

(i) **next-generation IT** - cloud-based services and AI;

(ii) **advanced hardware and software** - robotics and automation, semiconductors, advanced communication tech, electric and autonomous vehicles, advanced transportation tech, aerospace tech, advanced manufacturing, quantum information tech and computing and Metaverse tech;

(iii) **advanced materials** - synthetic biological materials, advanced inorganic materials, advanced composite materials and nanomaterials;

(iv) **new energy and environmental protection** - new energy generation, storage and transmission tech, and new green tech; and

(v) **new food and agricultural tech** - new tech for food production and processing (e.g., artificial meat, food waste reduction), and agricultural machinery, equipment and supplies (e.g., agricultural biotech / synthetic biology).

The in-scope industries (which are broadly based on the list of eligible industries for Shanghai's STAR Market) and sectors are contained in a non-exhaustive list in a guidance letter, with the intention that the list will be updated from time to time to reflect changing technology and after consultation with the SFC. Tech companies whose sector is not included can consider making pre-IPO submissions based on factors such as the sector's high growth potential, the application of new tech or application of tech / science to a new business model which differentiates it from traditional market participants, and the significance of R&D to the sector. **The Exchange also clarified in its guidance letter that a company operating in the biotech industry that does not base its listing application on a Regulated Product (as defined in Chapter 18A) may apply to list under the new regime as long as it meets the definition of a Specialist Technology Company.**

Companies with multiple business segments are not precluded if they can show they are *primarily* engaged in the specialist technology business. The Exchange will take into account a list of non-exhaustive factors set out in the guidance letter, including the portion of total operating expenditure dedicated to that business in the last three financial years, the extent to which the company's valuation is derived from that business, the intended use of proceeds, the proportion of revenue generated by that business relative to the total revenue of the company and the reason for retaining the non-Specialist Technology business segment(s) and the history of the company's operations.

Qualifications for listing

The consultation conclusions provide that listing eligibility criteria depends on whether the Specialist Technology Company has achieved at least HK$250 million in revenue (arising from the specialist tech segments) for the most recent audited financial year (**Commercial Companies**) or whether it has not reached this revenue threshold (**Pre-Commercial Companies**).

<table>
<tr><th></th><th>Commercial Companies</th><th>Pre-Commercial Companies</th></tr>
<tr><td>Expected market capitalisation at time of listing</td><td>At least HK$6 billion</td><td>At least HK$10 billion</td></tr>
<tr><td rowspan="2">R&D</td><td colspan="2">Engaged in R&D for at least three financial years prior to listing</td></tr>
<tr><td>R&D expenditure of at least 15% of total operating expenditure for each of the three financial years</td><td>R&D expenditure of at least:

(i) for Pre-Commercial Companies with revenue ≥ HK$150 million but < HK$250 million, 30% of total operating expenditure; and

(ii) for Pre-Commercial Companies with revenue of less than HK$150 million, 50% of total operating expenditure,

for the most recent audited financial year</td></tr>
<tr><td>Operational track record</td><td colspan="2">Generally, at least three financial years of operation under substantially the same management prior to listing</td></tr>
<tr><td>Ownership continuity</td><td colspan="2">12 months prior to listing</td></tr>
<tr><td>Third-party investment</td><td colspan="2">Meaningful investment from Sophisticated Independent Investors. As an indicative benchmark[2], this means:

Investment from Pathfinder SIIs:

<u>Two to five</u> Pathfinder SIIs that:

(a) in aggregate hold ≥ 10% of an applicant’s issued share capital as at the date of listing application and throughout the pre-application 12-month period; or

(b) otherwise have invested an aggregate sum of ≥ HK$1.5 billion in the applicant at least 12 months prior to the date of listing application (excluding any subsequent divestments made on or before the listing application);

provided that at least <u>two</u> such Pathfinder SIIs:

(a) each hold ≥ 3% of an applicant’s issued share capital as at the date of listing application and throughout the pre-application 12-month period; or</td></tr>
</table>

[2] For applicants already listed on other stock exchanges, the Exchange will consider, on a case-by-case basis, the specific circumstances of the applicant, including the shareholding of sophisticated independent investors before and at the time of the applicant’s overseas listing and at the time of the Chapter 18C listing application.

<table>
<tr><th></th><th>Commercial Companies</th><th>Pre-Commercial Companies</th></tr>
<tr><td></td><td colspan="2">(b) otherwise each have invested ≥ HK$450 million in the applicant at least 12 months prior to the date of listing application (excluding any subsequent divestments made on or before the listing application).

Investment from all “Sophisticated Independent Investors” at time of listing of:

Commercial Companies
<table>
<tr><th>Expected market capitalisation</th><th>Minimum total investment</th></tr>
<tr><td>≥ 6bn to < 15bn</td><td>20%</td></tr>
<tr><td>≥ 15bn to < 30bn</td><td>15%</td></tr>
<tr><td>≥ 30bn</td><td>10%</td></tr>
</table>
Pre-Commercial Companies
<table>
<tr><th>Expected market capitalisation</th><th>Minimum total investment</th></tr>
<tr><td>≥ 10bn to < 15bn</td><td>25%</td></tr>
<tr><td>≥ 15bn to < 30bn</td><td>20%</td></tr>
<tr><td>≥ 30bn</td><td>15%</td></tr>
</table>
</td></tr>
<tr><td>Commercialisation requirements</td><td>Not applicable</td><td>Demonstrate: (i) a credible path to achieving commercialisation (i.e., at least HK$250 million in revenue). The Exchange will look to binding and non-binding contracts in place with independent customers and the extent of potential contract value realisable within 24 months of listing; and (ii) its use of proceeds will primarily be for R&D and commercialisation of its specialist technology products</td></tr>
<tr><td>Working capital</td><td>Not applicable</td><td>Demonstrate sufficient working capital to cover at least 125% of its costs for the next 12 months</td></tr>
</table>

Pricing safeguards

In light of the potential difficulties of valuing Specialist Technology Companies and to ensure a robust price discovery that benefits from institutional investors’ professional assessment, the Exchange is requiring a minimum 50% allocation of IPO shares to independent price-setting investors and revising (downwards) the usual initial retail allocation and clawback mechanism. To ensure sufficient post-listing liquidity, the offer size should be “meaningful” with a minimum free float requirement (being shares not subject to any disposal restrictions at the time of listing) of HK$600 million[3].

Disclosure

Disclosure requirements in listing documents include details of the company's: (i) pre-IPO investments and cashflows; (ii) commercialisation status and prospects (including the key metrics specified in the Guidance Letter); (iii) R&D investment, expenditure, experience and risks; (iv) industry-specific standards, regulatory approval and safety data; and (v) IP. Additional disclosures apply to Pre-Commercial Companies regarding their path to achieving commercialisation, with mandatory progress updates in the interim and annual reports. Profit forecasts are not compulsory.

Post-IPO lock-ups

Lock-ups of 12 months (in the case of Commercial Companies) and 24 months (in the case of Pre-Commercial Companies) apply to controlling shareholders, and key persons such as founders, holders of weighted voting rights (**WVR**), executive directors, senior management and key personnel for technical operations and R&D. Lock-ups for Pathfinder SIIs are required for six months (in the case of Commercial Companies) and 12 months (in the case of Pre-Commercial Companies). Lock-up periods can be shortened if a Pre-Commercial Company achieves the Commercialisation Revenue Threshold during that period.

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[3] This refers to shares which are not subject to disposal restrictions and is in addition to meeting the existing “public float” requirement under Listing Rule 8.08(1).

WVR

Specialist Technology Companies listing under the new Chapter 18C are eligible for WVR structures provided they also satisfy the requirements under the WVR regime, including the higher market capitalisation requirement of HK$40 billion.

Conclusion

Hong Kong will be the first major Asian stock exchange (outside Mainland China) to open up the market to pre-revenue tech unicorns outside of biotech. Together with the recent expansion of the scope of eligible stocks for the Hong Kong-Shanghai and Hong Kong-Shenzhen stock connects, these are positive developments in attracting companies from across Asia and globally to the Hong Kong market.

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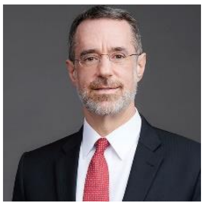

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