HKEx Reforms Attract High-Profile Technology and Biotech Listings

Skadden

06 / 18 / 19

If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.

Christopher W. Betts
Partner / Hong Kong
852.3740.4827
christopher.betts@skadden.com

Paloma Wang
Partner / Hong Kong
852.3740.6888
paloma.wang@skadden.com

Antony Dapiran
Of Counsel / Hong Kong
852.3740.4762
antony.dapiran@skadden.com

Four Times Square
New York, NY 10036
212.735.3000

42/F, Edinburgh Tower, The Landmark
15 Queen's Road Central, Hong Kong
Hong Kong
852.3740.4700

In the past year, nearly a dozen companies have taken advantage of new rules to list on the Stock Exchange of Hong Kong Limited (HKEx). On April 30, 2018, HKEx introduced a series of reforms to encourage the listing of high-tech, new-economy companies with dual-class share structures and pre-revenue biotech companies. Since then, two companies, Xiaomi Corporation and Meituan Dianping, with dual-class share structures (referred to by HKEx as "weighted voting rights," or WVRs) and seven biotech companies, including BeiGene, Innovent and CStone Pharmaceuticals, have listed in Hong Kong, demonstrating the success of these reforms.[1]

WVR Companies

HKEx has set a relatively high and subjective bar for listing with a WVR structure. HKEx has — and actively exercises — the power to choose which WVR listing applicants it considers appropriate. Applicants should consider making a preliminary submission to HKEx to determine whether they qualify as sufficiently "innovative" to list with a WVR structure. The following points should be addressed to substantiate "innovativeness":

- **Technology/Business Model:** An applicant must establish that its technology and/or business model is innovative and demonstrate how it benefits from the innovation and distinguishes itself from competitors.
- **Intellectual Property:** An applicant must have developed unique, registered IP rights that demonstrate innovation.
- **Research & Development:** An applicant must conduct significant R&D as evidence of its capability for innovation. This will need to be established through a track record of investing in R&D, with an explanation of historical R&D expenses and their proportion relative to total operating expenses.
- **Intangible Assets:** An applicant should be able to demonstrate that its current and/or expected market capitalization is relatively high compared to the carrying amount of tangible assets, and/or that the carrying amount of the company's intangible assets is relatively high as a proportion of total assets.

In addition to the qualitative requirements, HKEx applies a strict quantitative requirement: WVR applicants must have a market capitalization of at least HK$40 billion at the time of listing or a market capitalization of more than HK$10 billion and minimum revenues of HK$1 billion. If a listing applicant begins the application process as a WVR candidate but subsequent changes in market conditions prevent it from satisfying the market capitalization requirement, HKEx will require the applicant to drop the WVR structure and resubmit its listing application as a non-WVR company.

HKEx also has strict requirements as to who may hold WVR shares: Each WVR beneficiary must be a director of the company in an active executive role who has been key to the growth of the business. HKEx will require listing applicants to demonstrate to its satisfaction the contributions to the company made by each proposed WVR beneficiary.

While WVR shares may be held in a limited partnership, trust or private company for tax or estate planning purposes, an element of control must be retained by the WVR beneficiary over these entities, and any intermediate holding companies must be wholly

[1] Skadden advised the five named companies on their offerings.

owned by the WVR beneficiary. Additionally, post-listing transfers into and among these various controlled entities will require a waiver from HKEx. Therefore, any family trust arrangements with respect to WVR shares should be put in place before listing.

Biotech Companies

Companies producing the following categories of products may be eligible to list as biotech companies on HKEx: pharmaceuticals (small molecule drugs), biologics (new biologic products and biosimilars), medical devices, and "other products" subject to HKEx and Securities and Futures Commission approval. (However, we understand that regulators do not currently intend to approve any products in the "other" category.) In all cases, the products should be regulated by one of three internationally recognized authorities: the U.S. Food and Drug Administration, European Medicines Agency or the People's Republic China's National Medical Products Administration (or, with special approval, another national/supranational authority).

To list as a biotech company, an entity must be pre-profit and unable to meet any of the existing financial eligibility tests already provided in the HKEx Listing Rules.

HKEx requires a biotech company to have at least one "core product" beyond the concept stage — *i.e.*, Phase I clinical trials have been completed, and the product has been cleared by the relevant authority for Phase II clinical trials. The company must have engaged in active R&D of its core product for a minimum of 12 months prior to listing. Where that core product is in-licensed or acquired from third parties, the applicant must show R&D progress since the in-licensing/acquisition. HKEx will expect the IPO proceeds to be used primarily for the development and commercialization of the products identified as core products.

The company also must have received "meaningful" investment in the range of 1 percent to 5 percent of market capitalization (depending on the size of the company) from at least one third-party "sophisticated investor." Investors HKEx has accepted as "sophisticated" for these purposes include global health care and biotech funds, major pharmaceutical/health care companies, and large-scale investment funds, institutions and sovereign wealth funds.

A key concession HKEx has made in relation to biotech issuers is to permit existing shareholders to invest in the IPO, a practice not normally permitted under HKEx rules. An existing shareholder holding 5 percent or more of the company prior to the IPO may participate either as a cornerstone investor or through the bookbuild, provided that shares held by these existing shareholders will not count towards fulfilling the minimum public float requirement. Given the common market practice for biotech companies of turning to existing shareholders for follow-on financings, this concession from HKEx has been keenly embraced by the market.

HKEx has assembled a panel of industry experts to form a Biotech Advisory Panel that assists in reviewing listing applications and assessing the suitability of biotech companies. HKEx will readily entertain applications from listing applicants to exclude certain panel members from participating in the review of their listings if an actual or potential conflict of interest can be articulated.

Conclusion

The new rules already have made their mark in attracting a number of high-profile and successful listings to HKEx over the past 12 months. As market conditions evolve and investors, regulators and market participants alike become more familiar and comfortable with these new kinds of issuers, Hong Kong is expected to continue to develop into a vibrant hub for both new-economy and biotech companies seeking to list and raise capital in the international markets.