

LEX CAPITIS

IPO MENU FOR INVESTORS

It would be an understatement to say that the social unrest in 2019, trade war and Covid-19 presents a challenge for businesses. As we approach the mid-2020, businesses that are considering listing in Hong Kong might find it difficult to meet eligibility requirements unless special dispensation is given by the regulators. So what sort of Hong Kong IPOs should investors expect?

Trade War, Covid-19 & Co.

The confluence of the social unrest in 2019, trade war and Covid-19 has presented an enormous challenge to business. Businesses that are considering listing in Hong Kong may rather quickly find themselves ineligible under the Hong Kong Stock Exchange Listing Rules (“**Listing Rules**”).

56% of companies that listed in 2019 have either published an announcement or mentioned in its outlook to its financial results that it has been negatively affected or expects its financial performance to be negatively affected by the social unrest, trade war and/or Covid-19. For these companies, the expected adverse impact can be up to 40% of revenues/profit. Only 12% of such companies benefitted from the environment and 32% made no mention or expects little to no impact on its future financial performance.

Hence companies that would include 2020 financial results as part of its track record for listing eligibility may find it difficult to meet such requirements. In the absence of special dispensation from the regulators, investors may find themselves being presented investment propositions by companies that either has yet to generate revenues or profits. What do we mean by that?

2020-2021 IPO Vintage

Biotech companies that are raising public equity capital to develop and commercialise their research and development (“**R&D**”) portfolio tend to be pre-revenue businesses. The value of these companies lies in the quality and quantity

of their potential products and pipeline of potential products forming its R&D portfolio. Investment in these businesses tends to require specialist knowledge of the product being developed to avoid the investment of such investments becoming a binary outcome.

Large companies with strong growth trajectories are the second category of business that may choose to list. These companies may not make a profit or generate sufficient profits to meet the typical listing eligibility but have a sufficiently large market capitalisation that allows it to list after meeting certain revenue or cash-flow and revenue criteria under the Listing Rules. Examples of such companies that have already listed include online platform companies, gaming companies and other technology-related companies. Given the challenging global economic environment, investors need to be very confident that past drivers of revenues are still valid for future growth and such businesses to eventually become profitable.

Secondary listed companies such as Alibaba, JD.com and Netease are another category IPOs that investors may see. Such companies that their home market (primary) listing in another jurisdiction and since there are equivalent shareholder protection and Listing Rule compliance, they are given light-touch oversight by Hong Kong regulators. Whilst these companies add to Hong Kong’s reputation of being an equity capital market of choice in Asia. However, investors can always, if accessible, buy the stock in its home market rather than go through the application process to subscribe to such issues.

Special Dispensation?

In the year preceding periods of extreme market conditions and economic stress, the regulators have granted special dispensation for listing applicants that cannot meet the typical eligibility requirements. In 2009 the Stock Exchange of Hong Kong guided the market of factors it would consider for a possible waiver of the profit requirement under its listing eligibility criteria. In simple terms, a possible waiver for this listing eligibility criterion will be entertained if the listing applicant can prove its inability to meeting such criterion is temporary and its business is sustainable. Given the current extreme market conditions, will similar special dispensation be afforded again? Let's watch this space.

Lex Capitis is Odyssey Corporate Advisory's periodical that highlights capital and financial markets developments and its potential implications for you and your business.

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