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OCTOBER 2023

Hong Kong Spin-off Listings: Key Considerations

Introduction

This publication highlights the key considerations for businesses contemplating a Hong Kong spin-off listing. Spin-off listing refers to the separate listing of a part of a parent company's businesses or assets that are wholly or partly within its existing group.

This is particularly topical given global businesses with Asia operations are continuing to grapple with geopolitics and decoupling risks. The Biden administration recently issued an Executive Order to restrict certain US outbound investments into China (including Hong Kong and Macau) in three sectors - semiconductors and microelectronics, quantum information technologies and AI.

Several investment funds recently announced their plans to "spin off" their Greater China and/or Asia operations. There have also been media reports of major MNCs mulling spin-off plans, with some reportedly considering a separate listing of their Asia operations on the Hong Kong Stock Exchange (**HKEX**). A spin-off along geographical lines could potentially give MNCs more scope to insulate from decoupling risks by making both parent and Spinco more plausibly domestic and raise capital in the local markets. A separate listing would also offer the opportunity for the parent to sell down its stake in SpinCo after the spin-off listing if there is regulatory or economic pressure to do so. Once listed in Hong Kong, SpinCo could, subject to meeting eligibility requirements, tap into the significant pools of capital in Mainland China through inclusion in the Mainland China-Hong Kong Stock Connect scheme. International companies such as Prudential, HSBC and Samsonite are already benefitting from the scheme.

What are the requirements for a Hong Kong spin-off listing?

Listing eligibility

To be listed on the Main Board of the HKEX, a SpinCo must satisfy the requirements applicable to new listing applicants under the Listing Rules, including the basic criteria contained in Chapter 8. This includes (amongst others):

1. SpinCo should generally have a trading record of at least three financial years and fulfil one of the following three financial eligibility criteria:

    i. **Profit Test**: (a) profits attributable to shareholders of at least HK$35 million in the most recent financial year and aggregate profits of at least HK$45 million in the two years before that; and (b) market capitalisation of at least HK$500 million at the time of listing; or

    ii. **Market Capitalisation/Revenue/Cashflow Test**: (a) market capitalisation of at least HK$2 billion at the time of listing; (b) revenue of at least HK$500 million for the most recent audited financial year; and (c) positive cashflow from operating activities of at least HK$100 million in aggregate for the three preceding financial years; or

    iii. **Market Capitalisation/Revenue Test**: (a) market capitalisation of at least HK$4 billion at the time of listing; and (b) revenue of at least HK$500 million for the most recent audited financial year;

2. a public float of normally at least 25%, with market capitalisation of at least HK$125 million in public hands at the time of listing on the HKEX;

3. there should be ownership continuity for at least the most recent audited financial year and management continuity for at least the three preceding financial years prior to listing. SpinCo's core management group should therefore have been in place at SpinCo for at least this period;

4. it should have sufficient management presence in Hong Kong (normally meaning at least two executive directors must be resident in Hong Kong) – it is however possible to apply for a waiver from this requirement; and

5. there should be at least three independent non-executive directors (**INED**s) representing at least one-third of the board. At least one of the INEDs must have appropriate professional qualifications such as accounting expertise.

For biotech companies and "specialist technology companies", more relaxed listing eligibility requirements apply to them under Chapters 18A and 18C of the Listing Rules (for example, they can be pre-revenue if certain requirements are met).

Independence requirements

If the parent company of SpinCo is already listed on the HKEX, the separate listing of SpinCo on the HKEX will be subject to Practice Note 15 (**PN15**) of the Listing Rules, which requires SpinCo to demonstrate its independence from the parent company in various aspects (see below). Even where the parent company of SpinCo is not currently listed on the HKEX (which means the spin-off is not strictly speaking subject to PN15), the HKEX would also enquire into the independence of SpinCo during its vetting process.

The key principles of independence are:

1. *Clear delineation and non-competition* - there should be a clear delineation between the business(es) retained by the parent and the business(es) of SpinCo. For example, this may be delineation by sector, markets, upstream / downstream operations and/or (more likely in the context of decoupling risks) geographical regions. In practice, this is usually supported by a non-competition undertaking from the parent in favour of SpinCo. If no such undertaking is in place, a robust explanation and/or other safeguards will likely be needed.

2. *Independence from Parent* – although SpinCo can remain a subsidiary of the parent, the HKEX would consider whether SpinCo can function independently of the parent, particularly in relation to:

   i. Management independence – although common directors between the parent and SpinCo are not prohibited, there is an expectation that this should be kept to a minimum. There is no bright line test to determine an acceptable number of common directors – we have practical experience of arrangements and safeguards that the HKEX has considered acceptable and can explore possible arrangements with you.

   ii. Financial independence – the HKEX will consider arrangements, such as outstanding intra-group loans owed to the parent or loans guaranteed by the parent which are not proposed to be terminated upon listing, to assess whether SpinCo is overly reliant on the parent's support (e.g. whether it can easily obtain loans on similar terms without a parent guarantee).

   iii. Administrative / operational independence – the HKEX expects essential administrative functions to be carried out by SpinCo without relying on the parent. The sharing of administrative non-management functions (e.g. secretarial services) are generally allowed to some degree where there are clear commercial benefits.

   iv. Connected transactions – if any, between the parent and SpinCo, that occur or continue after listing must comply with the connected transaction rules under Chapter 14A of the Listing Rules. The connected transaction regime in Hong Kong is generally stricter than other jurisdictions due to the prevalence in the Hong Kong market of listed companies with controlling shareholders.

It is recognised that some degree of reliance may be inevitable in certain cases. Companies would need to demonstrate a clear commercial rationale for, and/or safeguards to manage, any significant reliance. For example, where SpinCo relies on an important trademark from the parent, the HKEX may expect a long-term trademark agreement with limited termination rights by the parent.

Conclusion

The principles of clear delineation and independence are not bright line tests. It is therefore important for SpinCo applicants to engage advisers with practical experience of what is likely to be acceptable to the HKEX, in particular whether certain separation measures would be sufficient to satisfy the key principles.

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Slaughter and May Hong Kong has advised on many high-profile spin-off listings on the HKEX, including Swire Pacific's spin-off of Swire Properties, Beijing Enterprises Water Group's spin-off of Beijing Enterprises Urban Resources and Nissin Foods' spin-off of Nissin Foods China, as well as spin-off listings on overseas exchanges such as Prudential's spin-off of Jackson Financial (now listed on NYSE) and M&G (now listed on LSE) and Tencent's spin-off of Tencent Music (listed on NYSE and HKEX).

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