

# GEM board repositioned

*Eugene Lai Yang-chau* explains the changes in GEM listing rules

New amendments to the listing rules for the Growth Enterprise Market kicked in on 1 July 2008. The amendments are the result of a consultation by the Stock Exchange of Hong Kong Ltd.

When the stock exchange opened GEM in 1999, the intention was to give Hong Kong an alternative market – like NASDAQ in New York or AIM in London – to capture start-up companies with potential but no track record. It would be a lightly regulated market, with companies operating on a disclosure basis. At the time, GEM had its own staff, set of rules and listing committee.

Since then, the performance of GEM board companies as a whole has been chancy – some have failed, some

have been embroiled in scandals, others have migrated to the main board.

These failures and scandals were signals for the exchange to start looking more closely at applications and transactions. The end result, according to exchange officials, was to harmonize the GEM and main board listing rules (*see table A*). Both sets of rules emphasize the protection of public interest.

Since early 2004, the staff and listing committees of GEM and the main board have been mostly unified. Under the amended rules, GEM keeps its listing committee (but with oversight and appeal responsibilities), but approvals for listing and the administration of listing rules go to the listing division of the main board.

Now, GEM serves the market as a secondary board for companies that have good prospects but do not yet meet the more stringent listing requirements of the main board. Exchange officials say potential GEM board applicants have these characteristics: high quality, growth potential, positive cash flow and scale. Meeting these characteristics give them access to public capital, which is what differentiates them from start-up companies. The two boards' regulatory approach, staffing and managerial supervision is primarily the same.

From now on, GEM companies will be judged a success when their share price increases and they are ready to transfer to the main board.

**Table A. GEM listing requirements**

	Old	New
Financial credentials	Business of substance and potential	Operating cash flow more than HK\$20 million in aggregate for the two latest financial years
Operating history and management	24 months active business pursuits (may be reduced to 12 months)	Latest two financial years under substantially the same management
Market capitalization	Effectively equal to or more than HK\$46 million (Equal to or more than HK\$500 million for companies with 12 months active business pursuits)	Equal to or more than HK\$100 million*
Focused line of business	Required	Not required
Approval by	GEM listing committee	Listing division

\* Main board market capitalization requirement is equal to or more than HK\$200 million.

## Key amendments

The amended GEM listing rules reflect its new role as the secondary board:

### **HK\$20 million positive cash flow listing requirement**

Under new quantitative admission requirements, listing applicants should have achieved positive cash flow of not less than HK\$20 million in aggregate for two preceding financial years. This is less stringent than the profits requirement or the HK\$100 million cash flow requirement for the main board if applicants choose to apply rule 8.05(2) of the main board listing rules.

This represents a departure from the old GEM listing rules by denying start-ups without positive cash flow access to the GEM market. It is also more clear-cut than the old GEM listing rule requiring applicants to

demonstrate their active business pursuits, which has been criticized as too subjective to interpret and apply.

Management is always key for a company's success. The positive cash flow requirement for the two latest financial years under substantially the same management is important in assuring investors about the company's performance. This is consistent with the rationale of the main board listing requirement of a three-year track record under substantially the same management and ownership.

The amended rules state that companies may only be transferred to the main board after they have been listed on GEM for a year and if they comply with GEM listing rules and meet all other main board admission requirements. The transfer will need the approval of the listing committee.

For future new listing applicants, the amended GEM quantitative admission requirements will provide a clearer benchmark for eligibility to the stock market and speed up the listing applications.

### **Listing division approval**

The power to approve the admission of new issuers to GEM will be delegated to the listing division, and the GEM listing committee will retain monitoring, review and appeal, and policy-setting responsibilities.

The move is expected to help address concerns about the duration and predictability of the listing process, and minimize the applicants' costs while maintaining regulatory standards. It is necessary to ensure

**Table B. Ongoing compliance requirements between old and new GEM listing rules**

	Old	New
Minimum public float	<ul style="list-style-type: none"> <li>Market capitalization less than or equal to HK\$4 billion: 25%</li> <li>Market capitalization more than HK\$4 billion: higher of HK\$1 billion and 20%</li> </ul> For companies listed before 1 October 2001: <ul style="list-style-type: none"> <li>Market capitalization less than or equal to HK\$1 billion: 20%</li> <li>Market capitalization more than HK\$1 billion and less than or equal to HK\$1.333 billion: HK\$200 million</li> <li>Market capitalization more than HK\$1.333 billion: 15%</li> </ul>	25% of total issued share capital, or 15%-25% of total issued share capital for market capitalization of more than HK\$10 billion
Business activity	No fundamental change in principal business activity for two years after listing unless with SEHK waiver and independent shareholders' prior approval	No fundamental change in principal business activities within one year after listing, unless with SEHK waiver and independent shareholders' prior approval
Sufficiency of operations	Sufficient operations	Sufficient operations or tangible assets and intangible assets

**Table C. Transfer arrangements to main board**

	Old	New
Process	Two steps: delisting from GEM and relisting on the main board	One step: transfer of listing from GEM to the main board
Cost	Standard initial listing fee for the main board	Main board initial listing fee reduced by 50% for GEM transfer applicants
Sponsor(s) or financial advisor(s)	Required	Not required
Listing document	Required	Listing document replaced by announcement

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that the listing division is capable of making executive decisions and a quick and ready process for review and appeal to the GEM listing committee. As a general rule, all listing applicants, irrespective of platform, should be subject to the same level of scrutiny to ensure the same protection to investors. The dual filing arrangement of listing documents with the Securities and Futures Commission will be maintained.

#### **Continuing obligations**

Continuing obligations of GEM listed issuers will be brought closer to the requirements applicable to the main board requirements. This should improve and shorten the listing division's vetting process, with more predictability for both listing applicants and investors, and lead to a reduction in time and costs.

The bulk of the old GEM compliance requirements will be maintained, including financial results reporting requirements and information disclosure of price sensitive information, connected transactions and notifiable transactions.

The amended rules minimize differences with the main board listing rules and reduce the barrier for a GEM

listed issuer to apply for a transfer to the main board (*see table B on the previous page*). Existing GEM issuers are required to comply with the new rules from their effective date, 1 July 2008, apart from the public float requirement, where they will be given a three-year grace period.

Now, GEM does not have requirements on tangible assets of sufficient value nor intangible assets for a potential value. The implications of the sufficient operations requirement is essentially whether existing GEM companies that do not meet such requirement may get delisted in future and what the relevant procedures are. The amended rules have not set out any detailed proposal or delisting procedure. This will likely depend on the stock exchange's policies and future amendments to the GEM listing rules, particularly if there are still GEM companies that cannot comply with the minimum public float requirement after the three-year grace period.

#### **Transfer to main board**

Under the amended rules, the listing transferal from GEM to the main board will be streamlined by way of

issuance of an announcement and with the listing committee's approval (*see table C*). The main board initial listing fee for all such transfers will be halved. These arrangements are in line with GEM being positioned as a secondary market to the main board.

Although the former delisting/relisting migration regime is technically still feasible, the stock exchange will encourage issuers to use the new streamlined regime, which will save time and money.

#### **Conclusion**

GEM is now reconstituted as a secondary market instead of an alternative market, with its own attraction for new listing applicants. The more established GEM-listed companies are likely encouraged to treat GEM as a stepping stone to the main board once the entry requirements are met. Other companies need to work on complying with the new GEM requirements, which are now similar to those of the main board.

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