HKEx GUIDANCE LETTER
HKEx-GL43-12 (October 2012)(Updated in July 2013)

Subject	**Guidance on Pre-IPO investments**
Listing Rules	**Main Board Rules 2.03(2) and (4)** **GEM Rules 2.06(2) and (4)**
Related Publications	**HKEx News Release (updated: 13/10/2010), Guidance Letters HKEx-GL29-12 ("Interim Guidance") and HKEx-GL44-12** **Listing Decisions superseded:** **1. HKEx-LD36-1 and 36-2** **2. HKEx-LD55-1, 55-2 and 55-3** **3. HKEx-LD59-1, 59-2, 59-3, 59-4, 59-5, 59-6 and 59-7**
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Important note: *This letter does not override the Listing Rules and is not a substitute for advice from qualified professional advisers. If there is any conflict or inconsistency between this letter and the Listing Rules, the Listing Rules prevail. You may consult the Listing Division on a confidential basis for an interpretation of the Listing Rules or this letter.*

1. Purpose

1.1 This guidance is a consolidation of listing decisions on pre-IPO investments which the Exchange issued in the past, and only principles applicable after the introduction of the Interim Guidance on 13 October 2010 are included in this Guidance Letter. Past listing decisions have been superseded.

1.2 Listing decisions HKEx-LD12-2011 on whether the Interim Guidance applied to a listing applicant seeking a secondary listing on the Main Board of the Exchange in June 2011 and HKEx-LD15-2011 on whether the Interim Guidance was applicable to an issue of shares upon exercise of warrants in July 2011 remain effective.

2. Applicable rules, regulations and principles

2.1 Main Board Listing Rules 2.03(2) and (4) (GEM Rules 2.06(2) and (4)) (the "**Rules**") require the issue and marketing of securities to be conducted in a fair and orderly manner and that all holders of listed securities be treated fairly and equally.

2.2 The Interim Guidance requires pre-IPO investments to be completed either (a) at least 28 clear days before the date of the first submission of the first listing application form or (b) 180 clear days before the first day of trading of the applicant's securities ("**28 Day/180 Day Requirement**"), except in very exceptional circumstances. Pre-IPO investments are considered completed when the funds are irrevocably settled and received by the applicant.

3. Atypical special rights/obligations attached to pre-IPO investments

3.1 Pre-IPO investors may be offered special rights. The range of these special rights is varied and while some rights are typical, atypical special rights or rights which do not extend to all other shareholders, are not permitted to survive after listing to comply with the general principle of even treatment of shareholders under the Rules. Below is a list of common special rights and our guidance on whether they are allowed to survive upon listing:

(a) Price adjustments

Disallowed:

- Any price adjustment provisions (e.g. a guaranteed discount to the IPO price or share price or an adjustment linked to the market capitalisation of the shares) which effectively create two different prices for the same securities for pre-IPO investors and other shareholders at the time of listing would potentially create a disruptive effect at the time of listing. They are contrary to the principles of the Rules and are not allowed.

(b) Put or exit options

Disallowed:

- All put or exit options granted to pre-IPO investors to put back the investments to the applicant or its controlling shareholder are against the Interim Guidance which requires pre-IPO investments to be irrevocably settled. *(Updated in July 2013)*

- The only event in which a put or exit option is allowed is when the terms of a pre-IPO investment clearly states that the put or exit option could only be exercised when listing does not take place. The put or exit option should not be exercisable in any other event. *(Updated in July 2013)*

(c) Director nomination rights

Disallowed:

- Any contractual right of a pre-IPO investor to nominate a director should not survive after listing as such a right is not generally available to other shareholders. The pre-IPO investors may nominate or appoint a director to the board before the applicant's listing. That director would be subject to the retirement and re-appointment requirements under the applicant's articles of association after listing.

(d) Veto rights

Disallowed:

- Pre-IPO investors may have a contractual right to exercise veto power over the applicant's major corporate actions, e.g. the making of any petition or passing of

any resolution for winding-up, the carrying on of any business other than the business being carried on by the applicant group, or the amalgamation or merger by any member of the applicant group with any other company or legal entity, etc. These rights should be terminated upon listing.

(e) Anti-dilution rights

- Under Main Board Rule 10.04 and Paragraph 5 of Appendix 6 to the Main Board Rules, no securities should be offered to existing shareholders of the issuer on a preferential basis and no preferential treatment should be given to them in the allocation of the securities.

- However, some pre-IPO investors are granted preferential rights to purchase additional securities to be issued by the applicants so as to maintain their percentages of shareholding in the applicants.

Allowed before listing:

- Exercise of these anti-dilution rights by the pre-IPO investors in the IPO is considered permissible at the time of listing where:
  - (i) the allocation is necessary in order to give effect to the pre-existing contractual rights of the pre-IPO investors under the relevant investor rights agreement;
  - (ii) full disclosure of the pre-existing contractual entitlement of the pre-IPO investors contained in the relevant investor rights agreement and the number of shares to be subscribed by the pre-IPO investors will be made in the listing document and the allotment results announcement; and
  - (iii) the proposed subscription will be conducted at the offer price of the IPO offering.

Disallowed:

- Anti-dilution rights should be extinguished upon listing to be in line with Main Board Rule 13.36 (GEM Rule 17.39) on pre-emptive rights.

(f) Profit guarantee

- Pre-IPO investors may be entitled to compensation if an applicant's profit does not meet a certain level in the future.

Allowed:

- Profit guarantee where the compensation is settled by a shareholder as it is seen to be a private arrangement between a shareholder and a pre-IPO investor and the compensation is not linked to the market price or capitalisation of the shares.

Disallowed:

- Profit guarantee if it is settled by the applicant or if the compensation is linked to the market price or market capitalization of the shares.

(g) Negative Pledges

Disallowed unless they are widely accepted provisions in loan agreements:

- Negative pledges generally restrict applicants from certain corporate actions such as creating any additional lien, encumbrance or security interest on its assets and revenues, or paying dividends without prior consent of the pre-IPO investor. They are generally provided in debt instruments, such as convertible bonds, in order to protect the bondholder's interests in its capacity as a creditor of the applicant.

- Negative pledges should generally be removed before listing unless they are widely accepted provisions in loan agreements, are not egregious and do not contravene the fairness principle in the Rules. Negative pledges which are regarded as widely accepted provisions include:

  (i) not to create or effect any mortgage, charge, pledge, lien or other security interest on an applicant's assets and revenues; and

  (ii) not to dispose of any interest in the economic rights or entitlements of a share the controlling shareholder owns or controls to any person.

- We will review all other negative pledges and may require confirmation from the sponsor that the relevant pledges which remain after listing are in line with normal terms of debt issues.

(h) Prior consent for certain corporate actions/ changes in articles

Disallowed unless the terms are not egregious and do not contravene the Rules:

- A pre-IPO investment agreement may provide that the consent of the pre-IPO investor is required before certain corporate actions can proceed. Examples of these actions include:

  (i) a declaration of dividend by any member of the applicant group;

  (ii) the sale, lease or transfer of a substantial part of the applicant's business or assets;

  (iii) any amendments to the applicant's constitutional documents; and

  (iv) any change in executive directors.

- These terms should be removed before listing unless the applicant can demonstrate that the relevant terms are not egregious and do not contravene fundamental principles to the disadvantage of other shareholders.

(i) Exclusivity rights and no more favourable terms

Disallowed unless the agreement is modified to include an explicit "fiduciary out" clause:

- A pre-IPO investment agreement may include terms that the applicant is not allowed to issue or offer any shares, options, warrants and rights to any direct competitor of the pre-IPO investor or to other investors on terms more favourable than the terms on which the shares are issued to the pre-IPO investor. These rights could potentially prevent the board of the applicant from considering bona fide alternative proposals that would be in the best interest of the applicant and its shareholders as a whole.

- However, these rights can survive after listing if the investment agreement is modified to include an explicit "fiduciary out" clause so that directors are allowed to ignore the terms if complying with the terms would constitute a breach of their fiduciary duties. The directors would not be prevented from exercising their judgment in whether to undertake certain corporate actions in the best interest of the applicant.

(j) Information rights

Allowed if the information is made available to the general public at the same time:

- Information rights can only survive after listing if the pre-IPO investor is only entitled to receive published information or information which is at the same time made available to the general public, with a view to avoiding unequal dissemination of information. If the issuer provides price sensitive information to the pre-IPO investor, the issuer needs to comply with the disclosure requirement under Main Board Rule 13.09 (GEM Rule 17.10), unless safe harbours in that Rule apply.

(k) Representation/ attendance rights

Allowed:

- Rights to nominate senior management and committee representative are contractually granted to pre-IPO investors but appointment is subject to the decision of the board. The board of directors are not contractually obligated to approve pre-IPO investor's nominations without further review as they owe fiduciary duties towards all the shareholders.

(l) Right of first refusal and tag-along rights

Allowed:

- The controlling shareholder of an applicant may grant a right of first refusal to a pre-IPO investor so that the controlling shareholder shall first offer to sell shares to the pre-IPO investor at the same price and on the same terms and conditions as a proposed sales of shares to a third party purchaser. If the pre-IPO investor does not exercise its right of first refusal, it shall be permitted to include its shares for sale together (i.e. tag-along) with the shares of the controlling shareholder as part of the sale to the third party purchaser.

- We consider that these rights, which intend to protect the pre-IPO investor's interest in the applicant by prohibiting the controlling shareholder from selling its shares to other parties, are purely contractual rights between two shareholders. Therefore, they should be allowed to survive after listing.

4. Qualified IPOs

4.1 Investment agreements with pre-IPO investors may include a term which states that if an applicant does not achieve a qualified IPO[1] within a specified period of time, the pre-IPO investors are entitled to a certain amount of compensation. We consider that this is allowed if the amount to be compensated is set out in the investment agreement or can be derived from the compensation provisions under the agreement. However, where the amount to be compensated is not set out in the investment agreement or cannot be derived from the compensation provisions under the agreement, it would be viewed as an amendment or variation to the original terms of the agreement and the 28 Day/180 Day Requirement under the Interim Guidance applies.

5. Lock-up and Public Float

5.1 Pre-IPO investors are usually requested by the applicant to lock-up their pre-IPO shares for a period of six months or more. These shares are counted as part of the public float so long as Main Board Rule 8.24 (note 3 to GEM Rule 11.23) (shares are not financed directly or indirectly by a connected person of the applicant) is fulfilled.

6. Disclosure requirements *(Updated in July 2013)*

6.1 The listing document should usually include the following information:

(a) in table format, details of the pre-IPO investments, including the name of each pre-IPO investor, date of investment, amount of consideration paid, payment date of the consideration, cost per share paid by each pre-IPO investor and the respective discount to the IPO price, use of proceeds from the pre-IPO investment and whether they have been fully utilized, strategic benefits they will bring to the applicant, and shareholding in the applicant held by each pre-IPO investor upon listing;

(b) the beneficial owner and background of each of the pre-IPO investors and their relationship with the applicant group and/ or any connected persons of the applicant;

(c) basis of determining the consideration paid by each pre-IPO investor;

(d) details of any special rights granted to the pre-IPO investors and that all special rights will be discontinued upon the applicant's listing. If not, how the applicant could comply with Main Board Rule 2.03(4) (GEM Rule 2.06(4)) and the principles set out in paragraph 3 of this Guidance Letter;

(e) whether the shares held by each pre-IPO investor will be subject to any lock-up after listing (as part of the terms of the pre-IPO investment) and, with basis, whether the shares held by the pre-IPO investors are considered as part of the public float for the purposes of Main Board Rule 8.08 (GEM Rule 11.23);

(f) if the pre-IPO investment is in the form of share-based payments:

[1] A public offering of securities valued at or above a total amount specified in an investment agreement. This amount is usually specified to be sufficiently large to guarantee that the IPO shares will trade in a major exchange.

(i) the accounting treatment of the pre-IPO investments;

(ii) the basis of the reporting accountants' view on the accounting treatment; and

(iii) a risk factor, if applicable, on the future impact on the applicant's profit and loss; and

(g) the sponsor's confirmation, with basis, that the pre-IPO investments are in compliance with the Interim Guidance, this Guidance Letter and Guidance Letter HKEx-GL44-12.

7. Pre-IPO investments not in accordance with the Interim Guidance, this Guidance Letter and Guidance Letter HKEx-GL44-12 *(Updated in July 2013)*

7.1 If a pre-IPO investment is not in accordance with the Interim Guidance (i.e. the 28 Day/180 Day Requirement) after submission of an applicant's listing application, the applicant is expected to:

(a) defer the listing date; or

(b) unwind the pre-IPO investment.

7.2 If a pre-IPO investment does not follow this Guidance Letter and/or Guidance Letter HKEx-GL44-12, the applicant has to:

(a) amend the terms of the pre-IPO investment (e.g. amend the conversion price to be at IPO price or remove a put or exit option) and follow the 180-day requirement set out in the Interim Guidance unless there is a legal opinion that the amendment to the terms of the pre-IPO investment will not constitute a new agreement (otherwise it will fall under the 28 Day/180 Day Requirement of the Interim Guidance); or

(b) unwind the pre-IPO investment.

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