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罗夏信律师事务所

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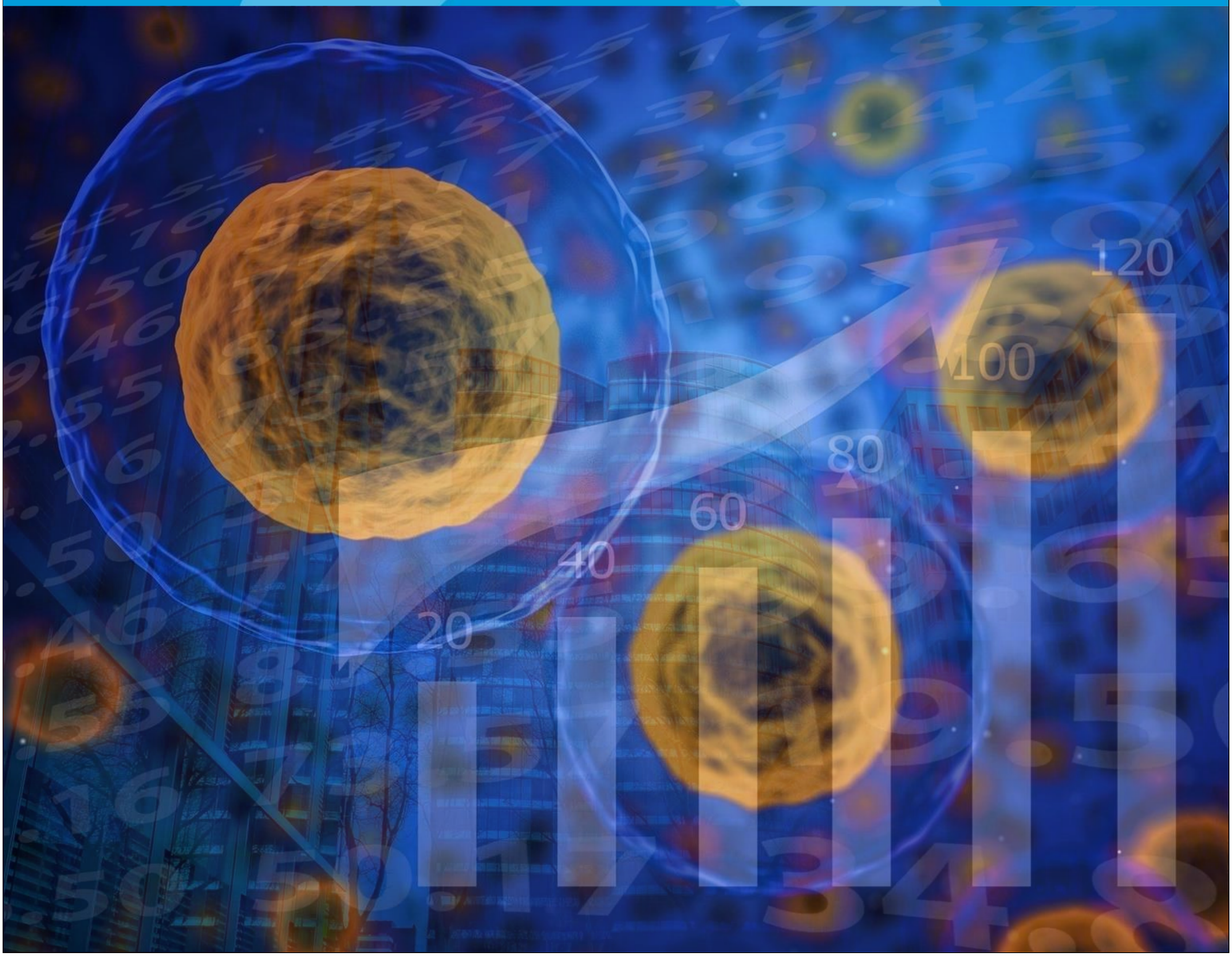
Biotech & life sciences

Biotech listings in Hong Kong



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Introduction

Global economic development, population growth, ageing society and technological advances have contributed to the considerable growth in the biotech industry in recent years.

Major global stock markets have in recent years developed new listing rules specifically for the biotech sector to facilitate effective allocation of venture capital and private equity funds, completing the "input-output" cycle of capital deployment and optimising resources allocation.

On 30 April 2018, the biggest change to Hong Kong Listing Rules for 25 years took place as new Listing Rules came into effect to include a new listing chapter (Chapter 18A) to welcome pre-revenue biotech companies.

Hong Kong's support for biotech companies

The new Listing Rules set out to address the funding challenges experienced by the global biotech industry: the lengthy research and development and approval processes for many biotech products often mean that the companies are unable to source sufficient funding in a timely manner before they can generate revenue.

It aims to broaden Hong Kong's listing regime to attract listings of a new generation of biotech companies amid growing competition from the US and Chinese stock exchanges.

> One year after the biotech listing regime was launched, Hong Kong has already become the world's second-largest funding hub for biotech

Chapter 18A recognises China Food and Drug Administration (CFDA) as a regulator qualified to assess biotech products – putting it on par with the US FDA and the European Medicine Agency (EMA). This is conducive to the application and promotion of Chinese standards in the international market.

The exit channel provided by the listing platform of the Hong Kong Stock Exchange may help attract more venture capital to the high-risk and high-return biotech field especially biotech companies based in Mainland China. Compared to investors in overseas markets, investors in the Hong Kong market may have a better understanding of Mainland China's regulations and market conditions, allowing them to better evaluate the investment risks in Mainland China's biotech companies. On the other hand, Mainland China's investors can buy biotech stocks listed in Hong Kong through Stock Connect, thereby helping to create a sound investor base for biotech companies and a good environment for financing of, and investment in, these companies.

Since the new listing regime launched on 30 April 2018, 15 biotech companies have already been listed on the Main Board of the Hong Kong Stock Exchange by August 2019, raising HK$48.6 billion in total. Among these, 8 pre-revenue biotech firms were listed through Chapter 18A, raising HK$23.5 billion. Many other companies are queuing up to list.

The biotech IPO pipeline in Hong Kong remains robust despite the global uncertainties in recent months. The Hong Kong Stock Exchange is confident that Hong Kong is on its way to becoming one of the world's major healthcare and biotech capital formation centres.

Asia-based CES HK Biotech Index (CESHKB) was launched on 14 November 2018 as the benchmark measuring the performance of HK-listed biotech stocks and to help investors diversify risk of investment in individual biotech stocks. It is notable that during the period between January 2019 and early March 2019, the annualised volatility of CESHKB was close to that of the NASDAQ Biotechnology Index and higher than that of the NASDAQ Composite Index in the same period.

Further, changes have been made to the Listing Rules to help innovative companies (with non-standard share structures and primary listings elsewhere) list on the Hong Kong Stock Exchange including:

- Chapter 8A permits listings of innovative companies with weighted voting rights structures.
- Chapter 19C offers a new concessionary secondary listing route for innovative companies that have their primary listings on the NYSE, NASDAQ or the Main Market of the LSEG (Premium).

The Hong Kong Stock Exchange hopes that these rule changes would allow it to overtake NASDAQ (currently the largest funding hub in the world) within five years in terms of the number and market capitalisation of Chinese biotech listings.

NASDAQ is always going to be an attractive listing destination for certain companies because it is a huge centre of liquidity and you already have that base of biotech investors and availability of comparables for valuations.

However, Hong Kong definitely has a role to play for certain companies, particularly for companies that rely on brand recognition that are looking to create markets among Chinese consumers. They will have a natural bias towards listing in Hong Kong. So within this bigger picture… the Exchange was right to create a chapter that allows these companies to list in markets that are close to their development home, to reflect that home country bias.

Fidelity International

Definition of biotech companies under the listing rules

Biotech companies are defined in the Listing Rules as companies primarily engaged in the research and development (R&D), application and commercialisation of biotech products, processes or technologies.

The definition of biotech is "the application of science and technology to produce commercial products with a medical or other biological application".

Note: The term "Biotech" is generic and includes life-sciences companies.

Basic listing requirements for biotech companies

Biotech companies that can meet the normal financial eligibility tests under Chapter 8 of the Listing Rules can list under the normal listing regime. In addition, the Hong Kong Stock Exchange has added a new Chapter 18A to the Listing Rules for the listing of biotech companies which cannot meet the Main Board's financial eligibility tests.

Chapter 18A suits the special financial characteristics and investments risks of biotech companies in their start-up stage (no profit or revenue for a long time before and after listing).

Pre-requisites to the listing of equity securities under Chapter 8

	Requirements	
	Categories	Remarks
1.	Satisfy one of these tests	Profit Test: • Profit of at least HK$20m for the most recent year. • Profit in aggregate of at least HK$30m for the two preceding years. • Profit excludes any income/loss generated by activities outside the ordinary and usual course of business.
		Market capitalisation/ revenue/cash flow test: • Market capitalisation of at least HK$2b at the time of listing. • Revenue of at least HK$500m for the most recent audited financial year. • Positive cash flow least HK$100m in aggregate for the three preceding financial years.
		Market capitalisation/ revenue test: • Market capitalisation of at least HK$4b at the time of listing. • Revenue of at least HK$500m for the most recent audited financial year.
2.	Ownership continuity	Ownership continuity for at least the most recent audited financial year.
3.	Management continuity	Management continuity for at least three preceding financial years.
4.	Market Capitalisation	Market capitalisation upon listing of at least HK$600m.

Requirements for pre-revenue biotech companies to list under Chapter 18A

A biotech company that does not meet the financial eligibility tests mentioned above can list under Chapter 18A if it can demonstrate the following main features:

	Requirements	
	Categories	Remarks
1.	Expected market capitalisation	Minimum market capitalisation of HK$1.5 billion
2.	Suitability for listing	In general, it must have developed beyond the concept stage: • at least one core product in the categories of pharmaceutical, biologics or medical devices (including diagnostics); and • such product is recognised by a competent authority such as EMA, FDA, NMPA and CFDA. For other biotech products, the Hong Kong Stock Exchange will consider on a case-by-case basis to determine if an applicant has demonstrated that the relevant biotech product has been developed beyond the concept stage by reference to the factors described above, and whether there is an appropriate framework or objective indicators for investors to make an informed investment decision regarding the listing applicant.
		It must have been primarily engaged in R&D for developing its core product(s) for at least 12 months before IPO (and in case of a product which is in-licensed or acquired from third parties, the applicant must demonstrate R&D progress since the in-licensing/acquisition).
		It must have as its primary reason for listing the raising of finance for R&D to bring its core product(s) to commercialisation.
		It must have registered patent(s), patent application(s) and/or IP relating to such core product(s).
		If the applicant is engaged in the R&D of pharmaceutical (small molecule drugs) products or biologic products, it must demonstrate that it has a pipeline of those potential products.
3.	Meaningful Investment from Sophisticated Investor	It must have previously received meaningful third party investment from at least one Sophisticated Investor at least 6 months before IPO. General examples of a "Sophisticated Investor": • a dedicated healthcare fund, biotech fund or established fund that specialises in biopharmaceutical sector; • a major pharmaceutical/healthcare company or its VC fund arm; • investor, investment fund or investment institution with minimum asset under management of HK$1 billion.

		"Meaningful Investment" is judged on a sliding scale depending on the market capitalisation of the applicant: Market Capitalisation — % of issued share capital on listing HK$1.5-3 billion — 5% or more HK$3-8 billion — 3% or more > HK$8 billion — 1% or more
4.	Track Record and continuity	It operates in its current line of business for at least 2 financial years prior to listing under substantially the same management.
5.	Working Capital	It must have working capital to cover at sufficient least 125% of its capital requirements for at least 12 months after IPO.

Why should biotech companies list in Hong Kong?

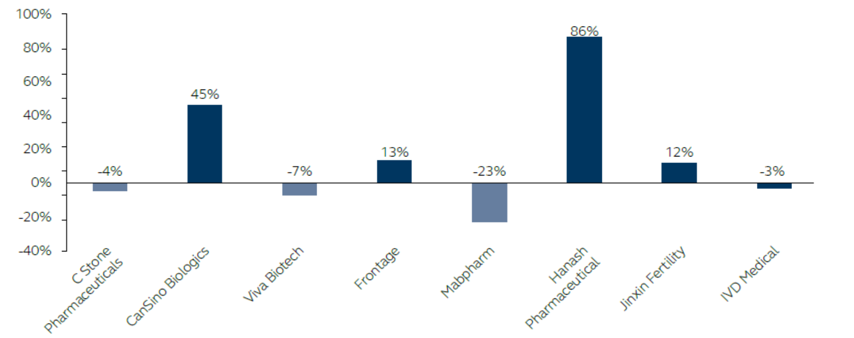
Advantages for listing in Hong Kong for ALL companies:

- Partner of choice for opportunities from China's internationalisation: Hong Kong is uniquely positioned as the key gateway between China and international markets.
- Stock-Connect with access to mainland china investors: stock-connect provides convenient and effective cross-border market access connecting China with the world.
- Diverse and global investor base: Hong Kong has access to a diverse and global investor base, which could potentially lead to a more liquid market.
- Funded jumbo IPOs: Hong Kong accommodates IPO transactions of all sizes and can secure healthy investor demand to price a successful transaction, including jumbo IPOs.
- Healthy and robust secondary market: Hong Kong possesses active secondary markets, providing a highly liquid, safe and efficient venue for refinancing and hedging activities.
- International corporate governance standards: International corporate governance requirements ensure transparency, accountability and trust in Hong Kong listed companies.
- Framework for cornerstone investors: The Hong Kong IPO listing regime allows for strategic cornerstone investors to enhance confidence and credibility, and to align long-term interests between the company and its shareholders.
- Sound regulatory regime: Hong Kong maintains a sound regulatory regime that is consistent with prevailing international practices, and allows for free flow of capital and information.
- Transparent process: The Hong Kong IPO application process is highly transparent, with a full listing guide published and the same standards applying to all applicants.

- Well established legal system: Hong Kong has a well-established legal system based on English common law which provides a strong and attractive foundation for companies to raise funds as well as confidence for investors.

Specific advantages for biotech companies:

- Ingredients readily available for biotech sector to thrive:
  - Unlike other regional centres e.g. Singapore, **HK has strong relations with China** particularly partnerships in the **Pearl River Delta (PRD) region**. E.g. Hong Kong has established a "**green channel**" with the Development District of Guangzhou [Canton] to enable the transfer of biological samples through simplified procedures.
  - Hong Kong has long **exposure to international business practices**.
  - Hong Kong is a good **location for R&D facilities** that customize Western technologies for the Chinese market. Hong Kong government provides a great deal of **support on R&D**. At present, the Hong Kong government accounts for 90% of the money spent on R&D in the city. In contrast, the US private sector accounts for 70% of R&D expenditures, while in Japan and Europe, the proportion is 80%.
  - Hong Kong combines investors, professionals, academics, policy experts and institutional and **regulatory foundations**.
  - Biotech is one of four I&T sectors the Hong Kong government has pledged to promote, most recently through the 2019-20 Budget. This includes plans to build a **Health@InnoHK research cluster** (focusing on healthcare-related technologies).



Source: HKEX, Dealogic & Bloomberg as of end August 2019

- Bypass financial eligibility test to fulfil equity funding need.
- The Hong Kong Stock Exchange has formed a Biotech Advisory Panel consisting of industry experts to assist in its review of listing applications from biotech companies applying under the new regime.
- Hong Kong is known as a market that treats investors fairly and protects their interests to the greatest extent possible from potential malfeasance. In line with investor protection, the new listing rules have significantly changed the ways available for shareholders to acquire their controlling stakes.
- In addition the traditional ways based on simple financial capital injections, the new listing rules allow shareholders to use other ways, such as **human capital** (like intellectual property and new business models) to establish their control, **without any change to how minority interests are being protected**.

Conclusion

There is no equivalent on other international exchanges, such as the NYSE, NASDAQ or LSE, to the new listing rules for biotech companies on the Hong Kong Stock Exchange.

The listing rule changes aim to attract more listing applicants from the high-growth tech and biotech sectors. Previously, financial requirements for listing on the Hong Kong Stock Exchange have acted as a bar to listing biotech companies whose R&D costs typically mean that they do not make profits for some time.

Asian investors and analysts are eager to build up experience and expertise to assess pharmaceutical companies. Hong Kong's new listing regime will no doubt attract more quality biotech companies to the region and instil new energy into the region's biotech industry.

In 2019, IPO issuers, in particular those with prominent mega deals, continued with their listing plans. Hong Kong Stock Exchange is set to retain the global IPO fundraising crown. According to one survey, Hong Kong is expected to have about 160 new listings to raise HK$220-250 billion in 2020.

The future appears bright for the rise of a new biotech IPO venue in Asia and the Hong Kong Stock Exchange may reap much reward for this audacious change.

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