

Private Equity and Venture Capital Pre-IPO Investments are now used by the Hong Kong Stock Exchange to Validate Pre-Revenue/Profit Biotech Companies

by Simon Chan, Esq.

Introduction

On April 30, 2018, the new listing regime published by The Stock Exchange of Hong Kong Limited (the “Exchange”) for companies from emerging and innovative sectors took effect. The new listing regime makes it possible for pre-revenue/profit biotech companies to apply for IPO on the Main Board of the Exchange. Without the ability to meet objective financial eligibility tests, how will the Exchange validate these pre-revenue/profit biotech companies? **Market and industry acceptance** will be part of the answer.

New requirements were introduced by the Exchange under this new listing regime with an aim to safeguard the interests of public investors. This eUpdate focuses on one interesting listing criteria applicable only to biotech companies which are seeking to list in Hong Kong under the new regime – **the requirement of receiving a meaningful third party investment from at least one sophisticated investor prior to the proposed listing.**

Underlying Listing Rule and Guidance Letter

A new Chapter 18A was added to the Main Board Listing Rules and a guidance letter (HKEX-GL92-18) (the “Guidance Letter”) was published in order to permit listing of biotech issuers that do not meet any of the Main Board financial eligibility tests.

Under Rule 18A.03(1) of Main Board Listing Rules, an applicant that has applied for listing under Chapter 18A must “demonstrate to the Exchange’s satisfaction that it is both eligible and suitable for listing as a Biotech Company”. The Guidance Letter provides guidance on the factors that the Exchange will take into account when considering whether an applicant is suitable for listing under Rule 18A.03(1) of the Main Board Listing Rules.

Among various factors set in the Guidance Letter, one requirement is that the applicant

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must have previously received meaningful third party investment (being more than just a token investment) from at least one “Sophisticated Investor” at least six months before the date of the proposed listing (which must remain at IPO).¹ This factor is intended to demonstrate that a reasonable degree of market and industry acceptance exists for the applicant’s R&D and Biotech Product. In another word, it provides a level of validation from an experienced third party investor of the applicant’s R&D and Biotech Product. We see this as a new concept being introduced by the Exchange – market acceptance and industry recognition is now used as part of the factors to assess the validity or commercial viability of pre-revenue/profit biotech companies.

How will the Exchange assess whether an investor is a “Sophisticated Investor”?

There is no “bright line” test under the Guidance Letter. The Exchange will assess whether an investor is a “Sophisticated Investor” for the purpose of applications for listing under Chapter 18A on a case by case basis by reference to factors such as net assets or assets under management, relevant investment experience, and the investor’s knowledge and expertise in the relevant field. For illustrative purposes only, the Exchange would generally consider the following types of investors as “Sophisticated Investors”:

- **a dedicated healthcare or Biotech fund or an established fund with a division/department that specializes or focuses on investments in the biopharmaceutical sector;**
- **a major pharmaceutical/healthcare company;**
- **a venture capital fund of a major pharmaceutical/healthcare company; or**
- **an investor, investment fund or financial institution with minimum assets under management of HK\$1 billion (equivalent to approximately US\$128 million).**

How will the Exchange assess whether a third party investment is a “meaningful investment”?

There is no “bright line” test either under the Guidance Letter. The Exchange will assess whether a third party investment is a meaningful investment in the circumstances on a case by case basis by reference to the nature of the investment, the amount invested, the size of the stake taken up and the timing of the investment. As an indicative benchmark per the Guidance Letter, the following investment amount will generally be considered as a “meaningful investment”:

Applicant’s market capitalization	Minimum amount of third party investment
HK\$1.5 billion – HK\$3 billion (equivalent to approximately US\$192 million to US\$384 million)	≥ 5% pf the issued share capital of the applicant at the time of listing

HK\$3 billion – HK\$8 billion (equivalent to approximately US\$384 million to US\$1,026 million)	≥ 3% pf the issued share capital of the applicant at the time of listing
≥ HK\$8 billion (equivalent to US\$1,026 million)	≥ 1% pf the issued share capital of the applicant at the time of listing

Future Growth Prospects

Since April 30, 2018, nine biotech companies had made listing filings under Chapter 18A and two of which had successfully listed on the Main Board of the Exchange.

It is expected that this new regime will enable more pre-revenue or pre-profit companies from the biotech industry to list on the Exchange. It is an area where there is great potential for growth, as only 3% of all Hong Kong-listed stocks come from tech and biotech sectors – according to report last year by the Exchange. This compares with 60% from Nasdaq and 47% from the New York. New York is currently the established center for biotech IPOs, with US\$2.4 billion worth of such shares sold last year.²

The expected demand in China and Asia for biotech related products and technological advancement are high. This will drive up momentum to push forward biotech technology, productization, market penetration, manufacturing, distribution and market standards. The new listing regime will provide financial funding needs as well as market and industry acceptance in this part of the world to help biotech companies achieve its business, technological advancement, and financial goals. This is one first chapters to a new era for the biotech industry.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed in this article or your regular Dorsey & Whitney contact.

¹ Where the applicant is a spin-off from a parent company, the Exchange may not require compliance with this factor if the applicant is able to otherwise demonstrate to the Exchange's satisfaction that a reasonable degree of market acceptance exists for its R&D and Biotech Product (for example, in the form of collaboration with other established R&D companies).

² News article titled "Ascleitis Pharma IPO raises \$3.1b" published on thestandard.com.hk on July 27, 2018.