SPIN-OFF TRANSACTIONS IN HONG KONG LISTINGS

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In this day and age, along with the continuous development of businesses, spin-off transactions have increasingly become prevalent in many economies worldwide.

This phenomenon occurs when a company aims to pursue its strategic objectives by reallocating financial resources away from non-core industries and concentrating more on its primary business activities.

To examine this trend further, it is essential to elucidate the term "**spin-off**". Although this term may vary from country to country because of the difference in legislation, the spin-off process generally refers to a company created by separating part of an existing company. This new entity operates independently but often retains a connection, especially beneficial interest to the parent company. This definition aligns with Vietnamese laws, which outline the procedure for establishing a new entity through the transfer of a portion of the existing company's assets, rights, and obligations without ceasing the existence of the original company ***(Article 199 of the Law on Enterprises 2020)***.

From the perspective of listing rules, spin-off transactions can be categorized into two types: conducting the spin-off before the listing and conducting the spin-off after the listing. In the former scenario, an existing company is still an unlisted one, which only needs to meet the statutory requirements applied for the spin-off process by-law of the relevant jurisdiction where the company was established and such spin-off process will b considered as a reorganization and pre-IPO step of the list-co. Meanwhile, in the latter scenario, as the existing company is a list-co, it must satisfy additional requirements that apply to listed companies to ensure transparency in the listing market, making this approach more complex and time-consuming.

The post-listing spin-off is often implemented to re-organize corporate resources or to circumvent the listing rules of certain Stock Exchanges for some business strategies. For example, under the practice note of the Hong Kong Stock Exchange – HKEx (Practice Note 15- PN15) as applied to both listed companies on Main Board and GEM Board, **one business cannot support two listings**. Therefore, some groups will normally implement spin-off transactions for re-assessing their compliance with the listing requirements.

Given the complication of the latter approach, each Stock Exchange may have its own guidance to support listed issuers on their compliance journey. In May 2024, the Hong Kong Stock Exchange (“**HKEx”**) noticeably issued a regulation newsletter to keep listed issuers updated on regulatory developments, including matters on spin-offs. In summary, the HKEx’s updates could be briefed as follows *(for details, please refer to the Listed Issuer Regulation Newsletter)*:

1. **Preparation of pro forma financial information of the remaining group as a kind of profit test** *(an existing company after a spin-off)*:[1] Providing a detailed reconciliation of its financial data, similar to its published financial statements and explaining major financial statement line items in the pro forma financials to show they arise from regular business activities of the remaining group.
2. **Requirement for the minimum market capitalization under looks of cash flow and revenue tests:** This requirement is a reasonableness test, depending on the issuer’s circumstances. There are two scenarios as below:

- For issuers with market capitalizations substantially above the minimum requirement, spinning off a small portion of the business, a simple test by subtracting the spinco’s valuation from the issuer’s market capitalization is typically sufficient; or
- Issuers with market capitalizations only slightly above the minimum requirement and/or spinning off a substantial part of their business must provide a more robust analysis as mentioned in Item 2(a). In this case, all necessary supporting information should be included in the first draft for increased scrutiny.

3. **Business description:** There are two the HKEx's suggestions for this matter as below:

- **Business delineation and non-competition**: Issuers must clearly outline the business models of both the remaining group and spinco, especially if they share similarities in terms of products, technologies, brands, customers, and suppliers. They should use plain language supported by industry-specific metrics, with up-stream and down-stream illustrations, avoiding jargon. Visual aids like charts may help. In case of the need to verify the non-competition, a corporate guarantee of the group holding company in favour of the spinco may benefit the applications.

- **Spinco group's independence**: Material transactions between the remaining group and spinco after the spin-off could question spinco's independence. Issuers should highlight such transactions in the proposal (in the pro forma financial information), explaining their nature and impact on spinco's independence (under looks of finance, management, administration and related party-transaction, etc.).

In contrast, Vietnam has its own regulations on securities governing spin-offs, which differ from those of the HKEx. For example, Vietnam requires financial statements from the two years before a spin-off rather than pro forma financial information and does not explicitly stipulate non-competition undertakings as a separate document. Apart from these disparities, both Stock Exchanges share the common goal of ensuring transparency in spin-off transactions.

In conclusion, despite slight differences in legislation, spin-off is often referred to as the process where a parent company creates new and independent companies by transferring parts of its business, without ceasing its own operations. In economic value, the spin-off approach allows a company to have flexibility in organizing its business purposes, enhancing the competitiveness of markets. When dealing with a listed company, the spin-off process involves a more complex procedure and requires additional documents to ensure transparency in the listing market. To alleviate this, apart from keeping updated on new guidance from the Stock Exchange to streamline the spin-off applications for the interest of time, the listed companies should also seek professional legal support from legal advisors practicing in relevant jurisdictions, including where their subsidiaries are located to have a comprehensive reorganization plan and spin-off proposal thereon.

These are only highlights of the key considerations for enterprises who contemplate a spin-off listing in Hong Kong Stock Exchanges. This publication is not a substitute for professional legal advice. This answer does not create an attorney-client relationship, nor is it a solicitation to offer legal advice. We however hope that the above is useful for your *purposes. If you are concerned that you have difficulty in finding a* **Hong Kong IPO Vietnamese advisor***, please contact us via email* info@gvlawyers.com.vn *or call us at +84 (28) 3622 3555.*

Author: *Ngo Thi Diem & Nguyen Ngoc Ho*

Footnotes

[1] For the purpose of assessing the listco's compliance with the financial track record requirement and the minimum market capitalization requirement, the following entities will normally be excluded in defining the "remaining group" by the HKEx: (i) Subsidiaries listed on the HKEx; and (ii) Subsidiaries not listed on the HKEx and previously spun off under PN15

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