

Subcommittee on Companies Ordinance (Exemption of Companies and Prospectuses from Compliance with Provisions) (Amendment) Notice 2011

This paper provides information in respect of items (a) – (c) below as requested by Members at the meeting on 29 November 2011.

(a) To consider the following suggestions from members:

- (i) **To put in place additional threshold(s) on valuation requirements for companies with non-property activities. A possible option is to require a company to provide a summary report instead of an overview (as proposed in the Amendment Notice) on each individual non-property activities interests if such interests have a value exceeding 15% of the total asset of the company; and**
- (ii) **In respect of companies with property activities interests, for a company which is exempted from the full valuation report requirement in the prospectus, to lower the threshold on the requirement to provide a summary on the full text of the valuation report so that more companies will be required to provide a summary instead of just an overview on such property interests.**

2. The SFC has further analysed some of the companies shown in the submission considered at the meeting of the subcommittee on 29 November 2011.

3. With regard to the suggestion at Item (a)(i) above, the table below demonstrates that valuation for individual property interest is clearly irrelevant for non-property activities interests. The SFC considers that there is no need to change the proposals.

	Company 10	Company 11	Company 12
Nature of business	Cement and concrete producer	Restaurant chain group	Renewable energy company
Total number of properties	75	113	92
- Owned	29	Nil	49
- Leased	46	113	43

	Company 10	Company 11	Company 12
Properties usage	Cement and concrete plants: 34 Office, residential use and others: 41	Restaurants: 27 Staff quarter: 76 Office, warehouse and others: 10	Wind farms: 29 Under construction: 9 Office, residential use and others: 54
Total property interests / total assets	33.4%	34.4%	36.9%
Properties above 1% of total assets	3 (cement plants): 3.1% 1.4% 1.1%	Nil	Nil
Breakdown of property interest	Construction in progress: 67.2% Land and buildings: 25.7% Others: 7.1%	Leasehold improvements: 71.5% Furniture, fixtures and equipment: 16.3% Construction in progress: 12.2%	Construction in progress: 90.1% Buildings and structures: 9.2%, Others: 0.7%
Valuation surplus / total assets	1.63%	Nil	0.03%

4. From the above examples, the valuation surplus¹ as a percentage of total assets is minimal. Based on our understanding, the valuation surplus for non-property activities interests are typically not significant and will not be reflected in the current or future financial statements of the companies.

¹ Valuation surplus refers to the valued amount minus book value based on cost.

Accordingly, a valuation is clearly irrelevant for a company's non-property activities interests.

5. With regard to the suggestion at Item (a)(ii) above, under the proposed exemption notice, 90% of the property interests of a company's property activities are still required to be valued. Although the percentage of exempted property interests in the following cases varies, the relative value of property interests that would not be valued and would be reported in an overview is small. In most cases the companies will still need to value over 95% of the total value of their property interests.

6. The last column of the below table shows that the value of the single largest property interest being exempted under the proposals is less than 0.5% of the total valued amount. Even if the threshold of 1% is lowered to 0.5%, none of the exempted property interests under the proposals would require a valuation.

	Proposed Exemption						Single largest property interest not valued
	Full valuation report		Summary of full valuation report		Overview		
	#	%	#	%	#	%	
Companies with property activities							
Company 13	1	10.4%	49	80.3%	45	9.3%	0.46%
Company 14	6	68.3%	13	30.0%	24	1.7%	0.40%
Company 15	6	80.3%	12	19.3%	19	0.5%	0.20%
Company 16	7	94.9%	3	5.1%	2	0.04%	0.04%
Company 17	4	41.9%	42	54.8%	52	3.3%	0.32%

(b) While under the proposals in the Amendment Notice companies are required to provide for public inspection the full text of the valuation report with respect to each summary property activities interests which is not covered by a valuation report set out in the prospectus, members noted that investors/interested parties have to go to the offices of the companies to inspect such reports. In order to provide convenience to investors, members suggested that SFC should consider requiring companies to make available the full valuation reports through electronic means, such as uploading the documents onto the company's website.

7. Under the proposals, summary property activities interests are subject to valuation. Instead of disclosing in the prospectus the full valuation report for these interests, a summary will be permitted. The information contained in the summary will be information extracted from the full valuation report. Such information should give investors a fair understanding of the interests, and generally there is little need for investors to go to the listing applicant's office to inspect the full valuation report.

8. Requiring companies to make available the full valuation report through electronic means raises a number of issues which require due consideration, for example, what is the consequence of a failure of the website for 1 hour or 1 day and the minimum period the valuations should be available. The SFC will coordinate with HKEx to explore and consult on the feasibility of making valuations available on a website. In the longer term, the SFC will also study the feasibility of incorporation by reference and other measures to reduce the bulk of the prospectuses.

(c) To consider measures to enhance wider use of electronic means for dissemination of information on companies to achieve early benefits in lowering the compliance cost on market participants, facilitating investors and enhancing sustainability in the securities market.

9. The SFC has taken measures to allow electronic means for dissemination of prospectuses. In April 2003, the SFC issued the "Guidelines for Electronic Public Offerings" to enable electronic public offerings to take place. In February 2011, a class exemption under section 9A of the Companies Ordinance (Exemption of Companies and Prospectuses from Compliance with Provisions) (Cap. 32L) was enacted. Under the class exemption notice, a listing applicant is permitted to issue paper application forms with electronic copies of the relevant prospectus.

Overall Assessment

10. In conclusion, international accounting standards do not require valuation for properties that are part of non-property activities. Even if a valuation is obtained to comply with listing requirements, the book value based on cost rather than the valued amount, would still be used in the company's balance sheet and financial statements. Hence, there is no point in requiring valuation for such properties and no other major market has imposed the same requirement. The existing Companies Ordinance requirement for routine valuations of such

properties is an anomaly arising from non-differentiation of properties and non-properties activities. The Amendment Notice seeks to remove this anomaly.

11. For property activities, the properties that may enjoy the proposed exemption from the valuation requirement (i.e. only need to provide an overview) would at most be 10% of the company's total asset, and the value of any such individual property must not exceed 1% of the company's total assets. As illustrated in the examples, the proposed exemption can eliminate the need for valuation for quite a large number of properties which account for a very small percentage of the company's total assets. When the locations of these exempt properties spread across a wide area, the savings or facilitation to the issuer could be significant. The only other major markets that have specific requirements for property valuations, the UK and Singapore, only require valuations for material or principal properties. The proposed amendment will bring Hong Kong closer to international requirements, but still have stricter requirements, and offer a bright line test to give the market more certainty as to the requirements.

The Securities and Futures Commission
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