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# Hong Kong Stock Exchange Publishes Guidance Letter On Profit Forecasts Under Main Board Rules 9.11(10)(B) And 11.17 (GEM Rule 14.29)

The Stock Exchange of Hong Kong (**Exchange**) published on 8 May 2012 a guidance letter (HKEx-GL35-12) on profit forecast in the IPO process to provide guidance and clarification on the following areas:

1. the difference between profit forecast and profit estimate;
2. situations in which profit forecast or a profit estimate need to be included in a listing document; and
3. the submission of a profit forecast memorandum irrespective of the repeal of Main Board Rule 8.21B.

The following provides a summary of the guidance letter which is available [here](gl35-12.pdf).

## Relevant Listing Rules

### Definition of profit forecast

The definition of profit forecast is provided in Main Board Rule 11.17 (GEM Rule 14.29). A profit forecast means any forecast of profits or losses, however worded, and includes any statement which explicitly or implicitly quantifies the anticipated level of future profits or losses or any other benchmark or point of reference. Profit forecast includes any profit estimate, being any estimate of profits or losses for a financial period which has expired but for which the results have not yet been audited or published. Any valuation of assets (other than land and buildings) or businesses acquired by an issuer based on discounted cash flows or projections of profits, earnings or cash flows will also be regarded as a profit forecast.

### Compliance requirements

Main Board Rule 11.17 (GEM Rule 14.29) requires that any profit forecast included in a listing document must be clear, unambiguous and presented in an explicit manner and the principal assumptions, including commercial assumptions on which the profit forecast is based, must be stated.

Main Board Rule 9.11(10)(b) provides that where a profit forecast is not included in a listing document, the relevant listing applicant is required to submit two copies of a draft of the board’s profit forecast memorandum and cash flow forecast memorandum to the Exchange at least 15 clear business days before the expected hearing date.

Main Board Rule 8.21B which provided that pre-listing research reports issued by the sponsor or underwriters or their related parties must not include any profit forecast or other forward looking statement unless such statement is included, in substantially the same form in the applicant’s listing document, was repealed on 1 February 2012. (For further information on the repeal, please see [our newsletter](/newsletters/hklaw/en/2012/145/nl-hklaw-20120206-145.html)).

## Guidance & Clarification

### Difference between profit forecast and profit estimate

According to Main Board Rule 11.17 (GEM Rule 14.29), a profit forecast includes a profit estimate. A profit forecast refers to any forecast of profits or losses, whereas a profit estimate means an estimate of profits or losses for a financial period which has expired but for which the results have not yet been audited or published.

Principal assumptions on which a profit forecast is based are required to be stated in a listing document pursuant to Main Board Rule 11.17 (GEM Rule 14.29). The Exchange explains that such principal assumptions are assumptions for major factors which affect a profit forecast and include, among others, political and economic condition, foreign exchange rate, inflation rate, interest rate and tax rate. According to Main Board Rule 11.19 (GEM Rule 14.31), the assumptions must provide useful information to investors to help them evaluate the reasonableness and reliability of the profit forecast.

The Exchange further clarifies that although a profit estimate is regarded as a profit forecast, the requirement to state assumptions in a listing document is not applicable to a profit estimate due to the fact that a profit estimate concerns a financial period which has already ended. Therefore, the factors influencing a profit estimate are already known and there is no need to state any assumptions.

### When to include a profit forecast or a profit estimate in a listing document

The inclusion of a profit forecast or a profit estimate in a listing document is entirely voluntary. The inclusion of a profit estimate is only required where the listing applicant applies for a waiver from strict compliance with Main Board Rule 4.04(1). Main Board Rule 4.04(1) requires a listing applicant to include in the accountants’ report its consolidated results for each of the three financial years immediately preceding the issue of the listing document. When a listing applicant issues its listing document within two months after the latest year end and applies for a waiver from strict compliance with Main Board Rule 4.04(1), the inclusion of a profit estimate in the listing document is one of the conditions that the Exchange would ordinarily expect in granting such waiver.

### Requirement to submit profit and cash flow forecast memorandum

Listing applicants are required to submit to the Exchange a profit and cash flow forecast memorandum at least 15 clear days before the expected hearing date under Rule 9.11(10). The Exchange explains that the rationale for this requirement is to prove the listing applicant’s sustainability and that the requirement remains despite the repeal of Main Board Rule 8.21B.

The Exchange also reminds listing applicants to note the difference in relation to the period required to be covered in the memorandum under Main Board Rules 9.11(10)(a) and 9.11(10)(b):

1. Main Board Rule 9.11(10)(a)

* Where the listing document contains a profit forecast, the profit forecast memorandum should cover the same period as the profit forecast and the cash flow forecast memorandum should cover at least 12 months from the expected date of publication of the listing document with principal assumptions, accounting policies and calculations for the forecasts.

1. Main Board Rule 9.11(10)(b)

* Where no profit forecast is included in the listing document, the profit forecast memorandum should cover the period up to the forthcoming financial year end date after the date of listing and the cash flow forecast memorandum should cover at least 12 months from the expected date of publication of the listing document with principal assumptions, accounting policies and calculations for the forecasts.

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