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By Phoebe Chan

# The buzz around spin-off listings in Hong Kong

Such listings have many benefits for companies but also involve regulatory safeguards

HONG Kong is known as a destination for spin-off listings. From 2018 to August 2022, 64 companies went public through spin-off listings on the domestic bourse, representing almost 10 per cent of initial public offerings (IPOs) in that period.

There continues to be buzz around such listings. For instance, Chinese Internet giant Alibaba Group last year announced plans to list its smart logistics arm Cainiao on the Hong Kong stock exchange, or HKEX, potentially raising US\$1 billion. It was touted to be among the hottest Asian IPOs.

Alibaba has since indicated that it may put the listing on hold, citing market conditions. Nevertheless, it is worth learning more about the appeal of spin-off listings in Hong Kong, and what companies and investors should look out for.

I sat down with Mike Tang, KPMG partner for Hong Kong and mainland China, for his perspective.

## Unlocking value

Many listed companies are keen on spin-off IPOs in Hong Kong because they deliver value to shareholders. "One of the most attractive aspects of spin-off listings lies in the ability to unlock the potential value of related – sometimes secondary – businesses and maximise shareholder value," Tang says.

Conglomerates with multiple business lines identify the business segment with the highest growth potential – often these are asset-light businesses – and then look to list them separately through the spin-off. Through the valuation process, the market helps realise the potential value of these businesses.

The market capitalisation of spin-off subsidiaries may sometimes even surpass that of the parent company, as the units enjoy higher price-to-earnings ratios. The parts come to be worth more than the whole, which perfectly illustrates the appeal of spin-off listings.

The same rationale applies to spin-off listings on the A-share market in mainland China, often involving highly sought-after concept stocks or companies in emerging industries. More than 30 Hong Kong-listed companies have successfully landed their business segments on the A-share market via spin-off listings since 2018, Tang notes.

The parent company usually retains ownership and control over the newly listed subsidiary, sharing the commercial benefits brought by the listing and further driving up its own stock price. This win-win scenario appeals to both the



Spin-off listings have boosted Hong Kong's competitiveness by increasing the number of new-economy listings. PHOTO: REUTERS

listed companies and the major shareholders.

## New financing channels

Spin-off listings also diversify a company's financing channels. For example, even with immense growth opportunities, biotechnology companies often lack access to funding during their research and development stages. This can leave them pressed for cash.

The spin-off listing opens an independent financing channel for such companies. It establishes a clearer and more attractive positioning, and gives the parent company added flexibility in its capital operations.

Having both onshore and offshore financing channels is a huge benefit, according to Tang.

"The effect of diversification is especially evident when the group has independent financing platforms both domestically and internationally," he says. "It helps mitigate the impacts of individual market volatilities on the group's overall financing capabilities and resilience."

Spin-off listings can also help companies reassess their businesses so that both the parent entity and the subsidiary can focus on their core segments. This, in turn, improves operational efficiency and overall competitiveness.

In addition, the equity incentive introduced by the spin-off motivates the subsidiary's management team and employees to achieve better performance.

## Regulatory safeguards

Spin-off listings have boosted Hong Kong's competitiveness by increasing the number of new-

economy listings, especially those of large, innovative platform companies. That said, regulatory safeguards are still vital to protect investors.

Tang identifies three key areas that the HKEX focuses on when reviewing spin-off listing applications:

### 1. Will the parent company still meet the listing requirements after the spin-off?

The exchange examines whether the parent company will retain sufficient assets post-spin-off and whether the remaining business will conform to the exchange's listing criteria around profitability and market capitalisation, among other requirements.

### 2. Does the spin-off listing serve the interests of current shareholders?

The HKEX considers the nature of the spin-off business itself, and also examines how a spin-off listing will impact existing shareholders. For businesses with promising returns, the exchange focuses on how the parent company can derive commercial benefits by retaining control over the subsidiary.

### 3. Will the spin-off be independent from the parent company?

The listing rules explicitly require that newly listed subsidiaries be independent from the parent company in terms of business, finance, and administrative management.

"Connected transactions between the newly listed subsidiary and the parent company are of particular concern," Tang says. "As the two become separate listed entities with their own shareholders, the HKEX will have to make sure there are no suspicions of transferring benefits to major shareholders through connected transactions."

## Proceed with caution

Companies seeking to spin off parts of their business into separate listings should conduct a comprehensive review beforehand. They should analyse market sentiment as well as the scope of the deal and what it may mean for the diversification of their business. They should also consider the potential obstacles that a spin-off listing could create.

That requires developing a concrete strategy and a long-term plan that takes into account the principles that the HKEX laid out. If the spin-off necessitates restructuring, the companies should engage with the relevant intermediaries early on to ensure a smooth listing process.

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