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**Alumni Seminar -
Capital Market Updates and
Preparing for HKFRS 16**

23 November 2018

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IPO Market Update

The Rules Changes

Updated listing requirements for MB and GEM

Effective 15 February 2018



A new listing regime since 30 April 2018

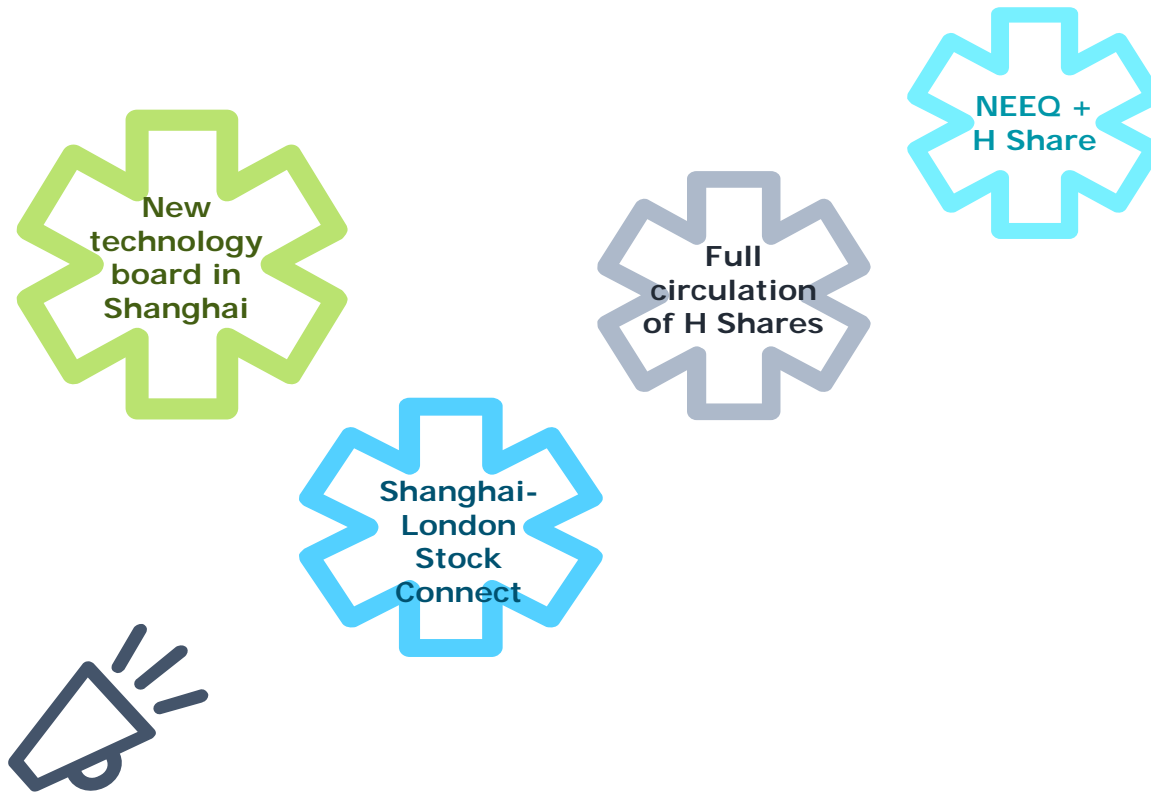
3 new chapters in the Main Board Listing Rules for biotech issuers, companies with weighted voting rights (WVR) and a new concessionary secondary listing route

Companies from the innovative sectors (Min. expected market capitalisation of HK\$10 billion at listing time)			
1.	Chapter 18A - biotech companies that do not meet any of the MB financial eligibility tests	2.	Chapter 8A - with WVR structures
		3.	Chapter 19C - new secondary listing regime
	<ul style="list-style-type: none"> • A minimum expected market capitalisation of HK\$1.5 billion at time of listing • Has been in operation in its current line of business for at least two financial years under substantially the same management prior to listing • Must meet the available working capital requirements to cover at least 125% of the issuer's costs (including general, administrative, operating and R&D costs) for at least 12 months from the date of publication of its listing document after taking the IPO proceeds into account • Must have previously received meaningful third party investment from at least one sophisticated investor at least six months before the date of the proposed listing* 	<ul style="list-style-type: none"> • Only applications for listing from new applicants will be considered • If below HK\$40 billion of expected market capitalisation at time of listing, it would need to have at least HK\$1 billion revenue in its most recent audited financial year ("Revenue Test") • WVR shares must not seek for a listing • The voting power attached to WVR shares to be capped to not more than 10 times of the voting power of ordinary shares 	<ul style="list-style-type: none"> • To attract Greater China issuers that have been primary listed on the New York Stock Exchange, Nasdaq or the London Stock Exchange's Main Market ("premium" only) for at least two full financial years to list in HK • If the secondary listing applicants with a WVR structure and/or is a Greater China issuer will also have to meet the Revenue Test if it has an expected market capitalisation below HK\$40 billion at time of secondary listing • A non-Greater China issuer without a WVR structure must have an expected market capitalization at time of secondary listing of at least HK\$10 billion • Listing applications can be submitted on a confidential basis.

*HKEX Guidance Letter HKEX-GL92-18

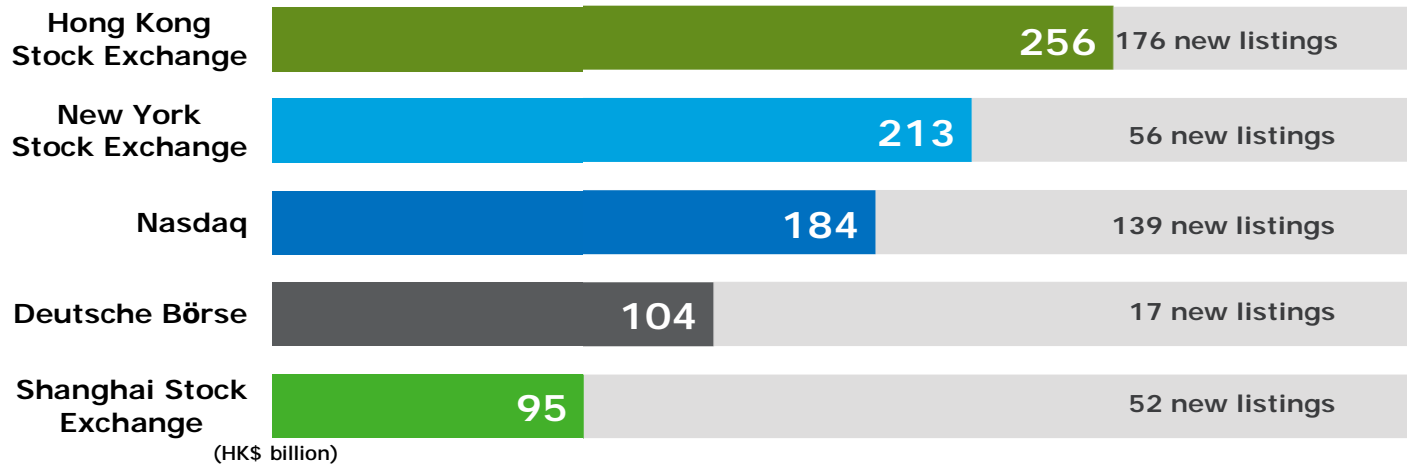
The Market Perspective

The market spotlights fall on



HK regains no. 1, NYSE trails with six mega IPOs

IPO proceeds raised by key global stock exchanges (Jan-Oct 2018)



HKEX regained no. 1 position with the world's two largest IPOs year-to-date, China Tower and Xiaomi



NYSE surpassed other stock exchanges with two mega IPOs that raised funds nearly as much as China Tower's IPO



Two Chinese concept stocks that raised over HK\$10 billion each helped **Nasdaq** cemented its 3rd place



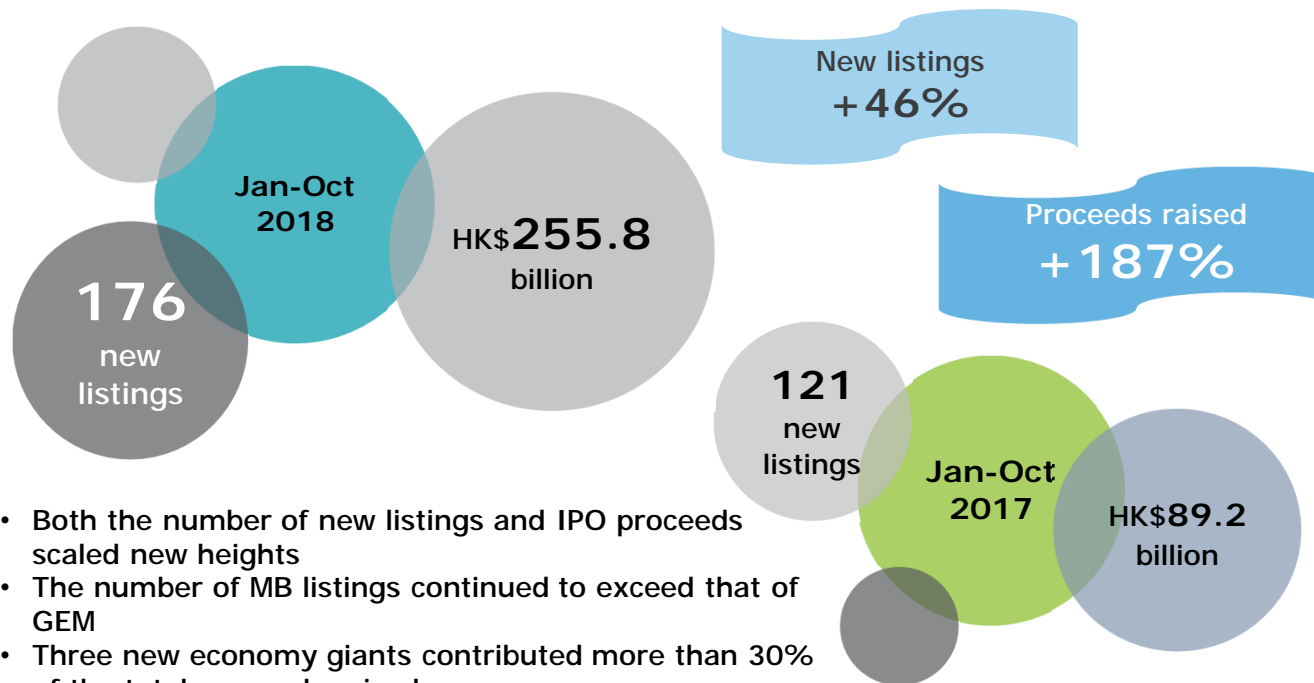
Deutsche Börse surpassed Shanghai through another new listing that raised more than HK\$10 billion in the first half of October



Shanghai Stock Exchange could only take up the 5th position with one small new listing in October although completed the listings of Foxconn Industrial Internet and others earlier

Source: NYSE, Nasdaq, CSRC, Deutsche Börse, HKEX, Bloomberg and Deloitte's analysis as at 31 October 2018; excluding proceeds raised from the exercise of over-allotment options after 31 October 2018 by IPOs that were debuted in October 2018. Including proceeds raised from the listings of real estate investment trusts, but excluding proceeds raised from investment trust companies, close-end investment companies, and close-end funds and special purpose acquisition companies

Both the number of new listings and IPO proceeds in the first 10 months of 2018 rose strongly in HK

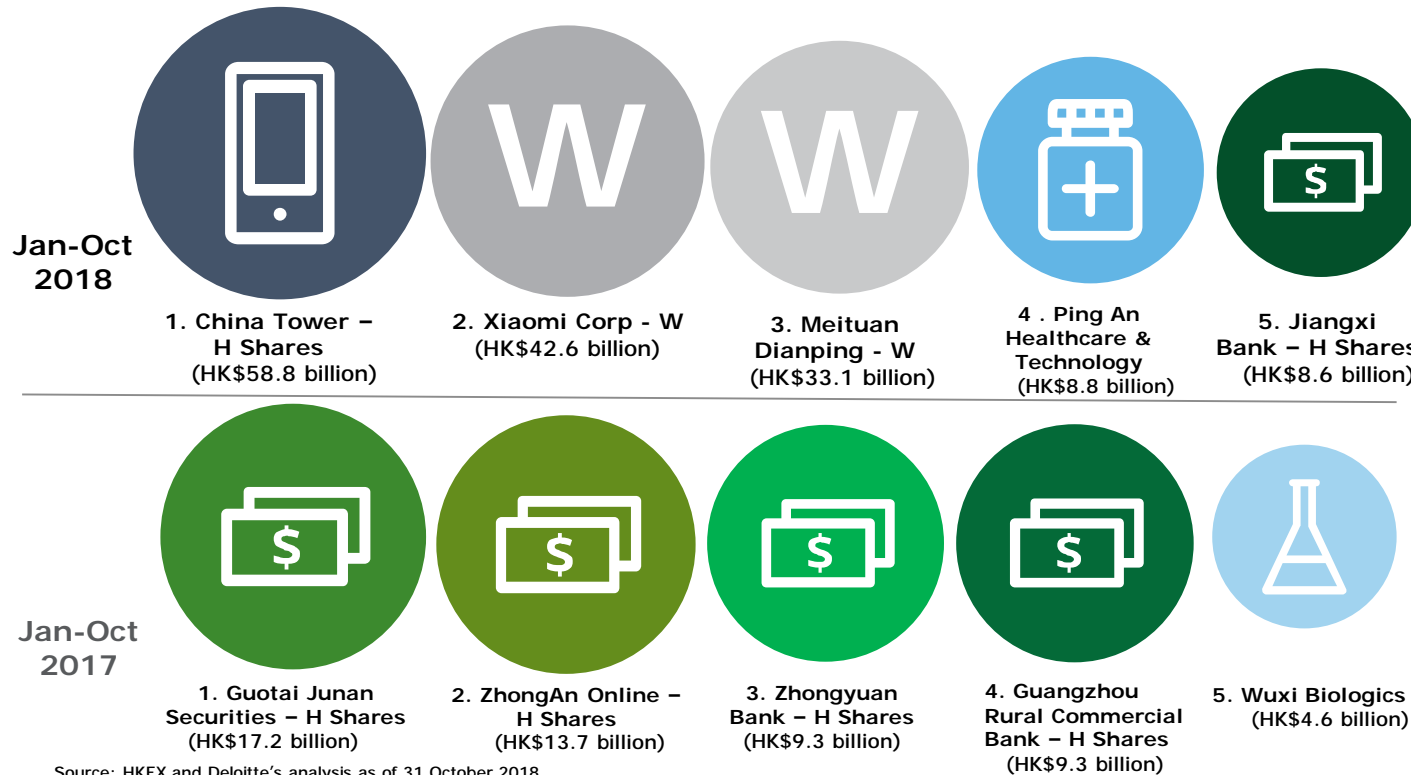


- Both the number of new listings and IPO proceeds scaled new heights
- The number of MB listings continued to exceed that of GEM
- Three new economy giants contributed more than 30% of the total proceeds raised

Source: HKEX and Deloitte's analysis as of 31 October 2018; excluding proceeds raised from the exercise of over-allotment options of the newly listed companies on MB, which did not announce their price stabilization actions by 31 October 2018.

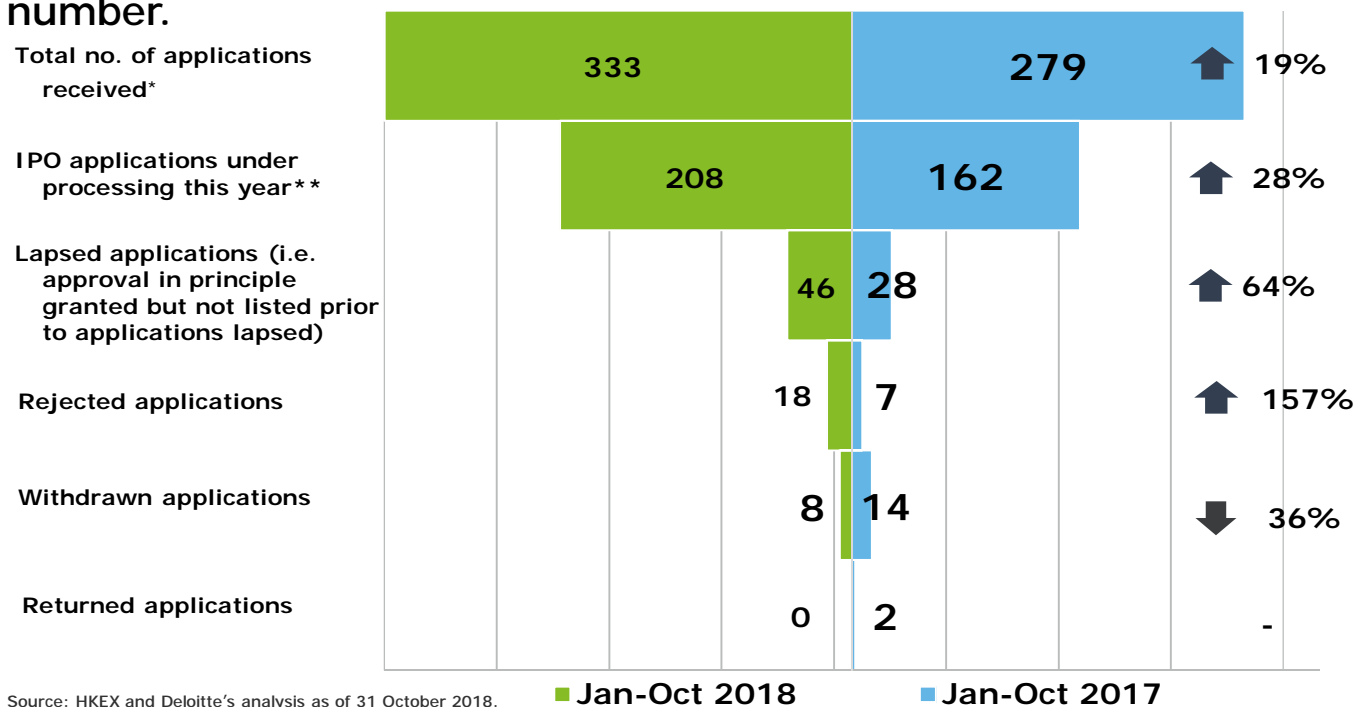
Overview of HK's IPO market – Jan-Oct 2018

Thanks to the three IPOs raising more than HK\$30 billion of proceeds each, total proceeds raised from the top 5 IPOs in the first 10 months of 2018 reached HK\$151.9 billion, almost a threefold increase over HK\$54.1 billion of the same period of 2018. New economy IPOs played an important role in HK's IPO market.



Source: HKEX and Deloitte's analysis as of 31 October 2018.

IPO applications received and under processing, lapsed applications with approval in principle granted, and rejected applications in the first 10 months of the year all rose in number.

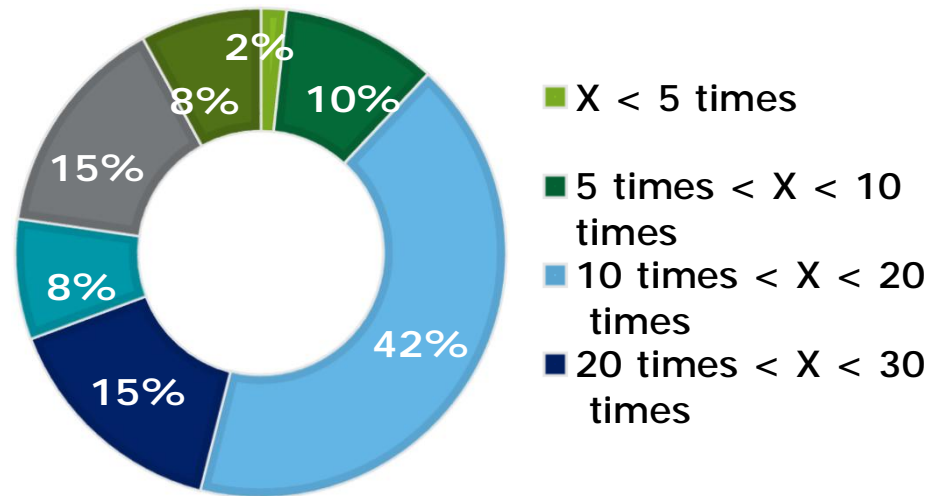


Source: HKEX and Deloitte's analysis as of 31 October 2018.

*Includes application(s) by investment vehicle(s) pursuant to Chapters 20 and 21 of the Main Board Listing Rules, application(s) for transfer of listing from GEM to the Main Board, and deemed new applicant(s) pursuant to Main Board Listing Rule 8.21C or Main Board Listing Rule 14.84, and very substantial acquisition(s) treated as reverse takeover(s) pursuant to Main Board Listing Rule 14.06(6)/GEM Listing Rule 19.06(6).

**Figure of the first 10 months of 2018 includes new IPO applications accepted since 1 January 2018 and figure of the first 10 months of 2017 includes new IPO applications accepted since 1 January 2017

In the first 10 months of 2018, nearly 40% of IPOs were priced at P/E ratios of at least 20 times.



- 42% of IPOs were priced at P/E ratios of 10-20 times, down by 10 percentage points from 52% of the same period last year.
- Nearly 40% (38%) of IPOs were priced at P/E ratios of 20 times or above, up by 10 percentage points from 28% of last year.

Source: HKEX and Deloitte's analysis as of 31 October 2018; excluding proceeds raised from the exercise of over-allotment options of the newly listed companies on MB, which did not announce their price stabilization actions by 31 October 2018.

HKFRS 16

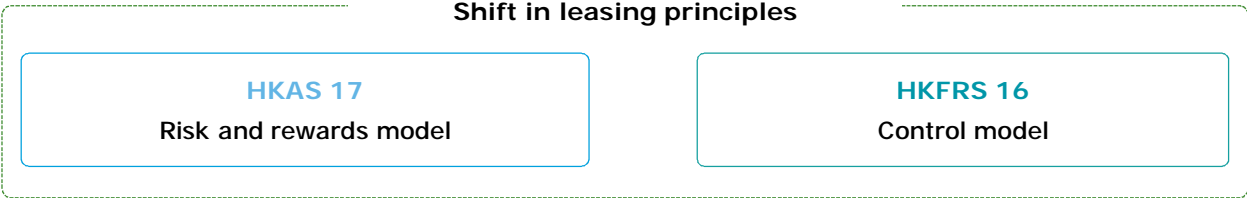
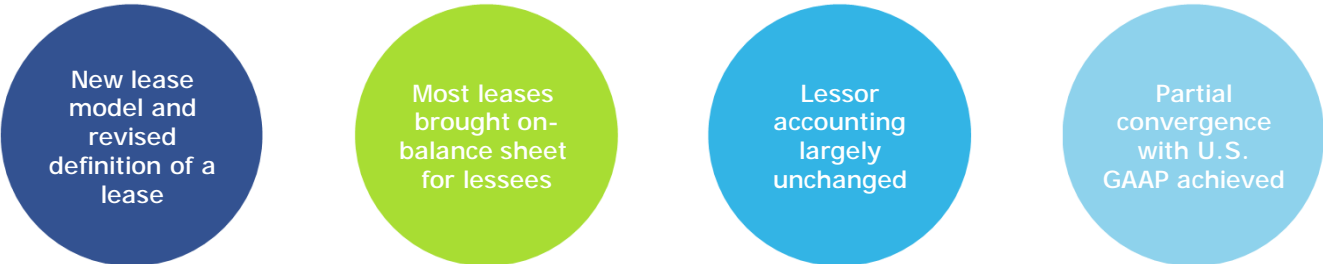
HKFRS 16

What are the key impacts?



Highlights

Effective on 1 January 2019



HKFRS 16 key change for lessees >>> The finance lease/operating lease distinction under HKAS 17 is no longer relevant under HKFRS 16 for lessees. Instead, most leases will have to be recognised as "right-of-use" asset with a related liability, with subsequent accounting similar to the finance lease model under HKAS 17.



Knowledge Check

Your Company now applies
HKFRS 16...



What is the impact on our client's
assets and liabilities?

A Assets and liabilities will increase

B Assets will increase, liabilities will decrease

C Assets will decrease, liabilities will increase



Knowledge Check

Your Company now applies
HKFRS 16...



What is the impact on our client's
assets and liabilities?

A Assets and liabilities will increase

B Assets will increase, liabilities will decrease

C Assets will decrease, liabilities will increase



Knowledge Check

Your Company now applies
HKFRS 16...



What is the impact on our client's
net cash flows from operating activities?

A Increase

B Decrease

C It depends



Knowledge Check

Your Company now applies
HKFRS 16...



What is the impact on our client's
net cash flows from operating activities?

A Increase

B Decrease

C It depends



Knowledge Check

Your Company now applies
HKFRS 16...



What is the impact on our client's **Earnings Before Interest, Tax, Depreciation and Amortization (EBITDA)**?

A Increase

B Decrease

C It depends



Knowledge Check

Your Company now applies
HKFRS 16...



What is the impact on our client's **Earnings Before Interest, Tax, Depreciation and Amortization (EBITDA)**?

A Increase

B Decrease

C It depends



Knowledge Check

Your Company now applies
HKFRS 16...



What is the impact on our client's
current ratio (current assets/current liabilities)?

A Increase

B Decrease

C It depends



Knowledge Check

Your Company now applies
HKFRS 16...



What is the impact on our client's
current ratio (current assets/current liabilities)?

A Increase

B Decrease

C It depends

Impacts on Financials – Greater Lease Assets & Liabilities

Under HKFRS 16, all leases will be recognized as finance leases going forward. This puts significant amount of lease assets and liabilities back on the balance sheet and affects the expense composition and timing.

Finance Statement Level	Account Balances / Classes of Transactions	HKAS 17 (Old Standard)		HKFRS 16 (New Standard)
		Finance Leases	Operating Leases	All Leases
Balance Sheet & Footnotes	Assets			
	Liabilities	\$ \$		\$ \$
	Lease Commitment			
Income Statement	Rental Income		\$	\$
	Finance Income	\$		\$
	Rental Expenses			
	EBITDA			
	Depreciation	\$		\$
	Operating Profit			
	Finance Costs	\$		\$
Profit before tax				

Major Impacts

- Wide-spread impacts over financial compositions**, with increase in assets and liabilities as well as higher expense in earlier years of the lease (see graph on the left)
- Changes in key financial ratios**, in which **higher gearing ratio, lower asset turnover, and greater EBITDA and operating profits** are expected.
- Potential increase in capital requirement/borrowing costs / compensation**, resulted from the change in financial ratios / compositions
- Additional burden in financial reporting**, as more complex calculation and processing are needed to record and report finance leases.
- How do you do business with your customers?** Increase demand from customer for **shorter lease terms, more variable lease payments, put pressure on pricing leases amount, etc.** This may impact your business model & lease products such as increase focus on services rather than physical assets.

HKFRS 16


Are we really need to
consider all leases?



Practical Expedients-Recognition exemptions

HKFRS 16 applies to all leases, except in the following cases.....

Accounting policy option:
Apply HKFRS 16 or apply exemptions



Short term lease
(12 months or less)

Leases that include purchase options are not short term leases

Election by underlying asset class



Low value assets

Evaluate on an absolute basis

Election on a lease-by-lease basis

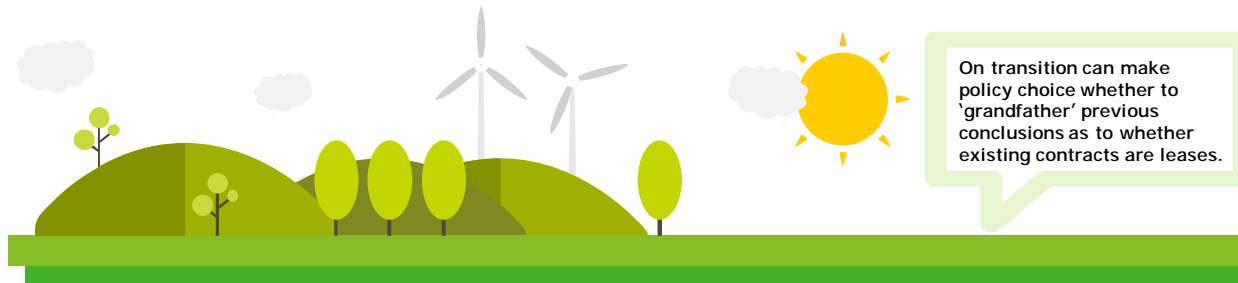
HKFRS 16

What is a lease?



Scope

Definition of a lease



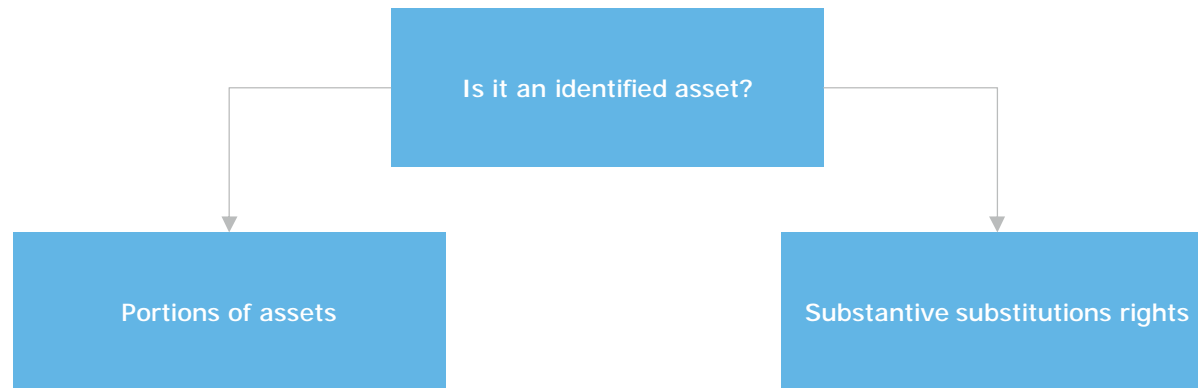
On transition can make policy choice whether to 'grandfather' previous conclusions as to whether existing contracts are leases.

A lease conveys the right to **control** the use of an **identified asset** for a period of time in exchange for consideration.

<p>The customer has both the right:</p> <ul style="list-style-type: none"> • To direct the identified asset's use. • To obtain substantially all the economic benefits from that use. 	<p>Typically identified by being explicitly specified in a contract, but can also be implicitly specified at the time made available for use by customer.</p>	<p>No identified asset if supplier has both:</p> <ul style="list-style-type: none"> • The practical ability to substitute alternative assets throughout the period of use, and • They would economically benefit from substitution. 	<p>Capacity portions</p> <ul style="list-style-type: none"> • A capacity portion is an identified asset if physically distinct (e.g., a floor of a building). • If not physically distinct (e.g., capacity portion of a pipeline or fibre optic cable), then not an identified asset...unless it represents substantially all of the capacity, such that customer has right to substantially all of the economic benefits. • Even so, customer is unlikely to have right to control the use of non-physically distinct capacity portion, as decisions are typically made at the larger asset level.
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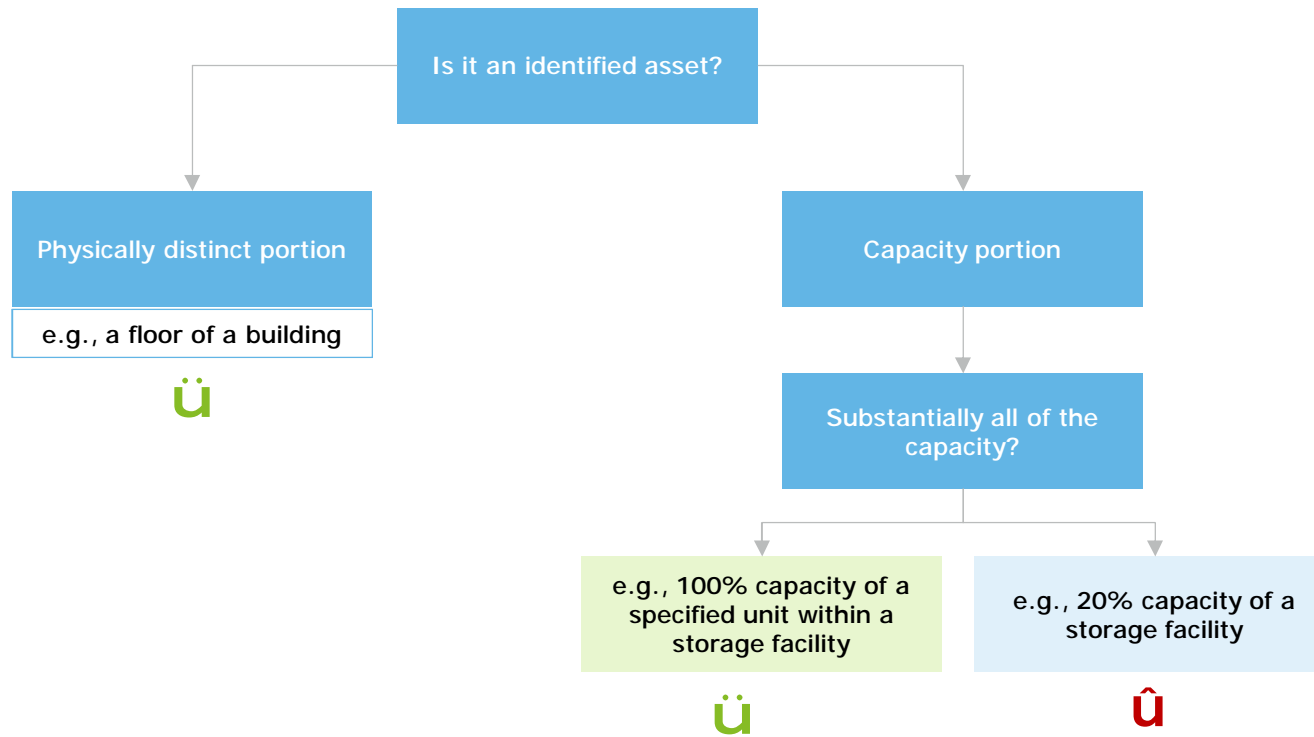
Identified asset

What to consider...

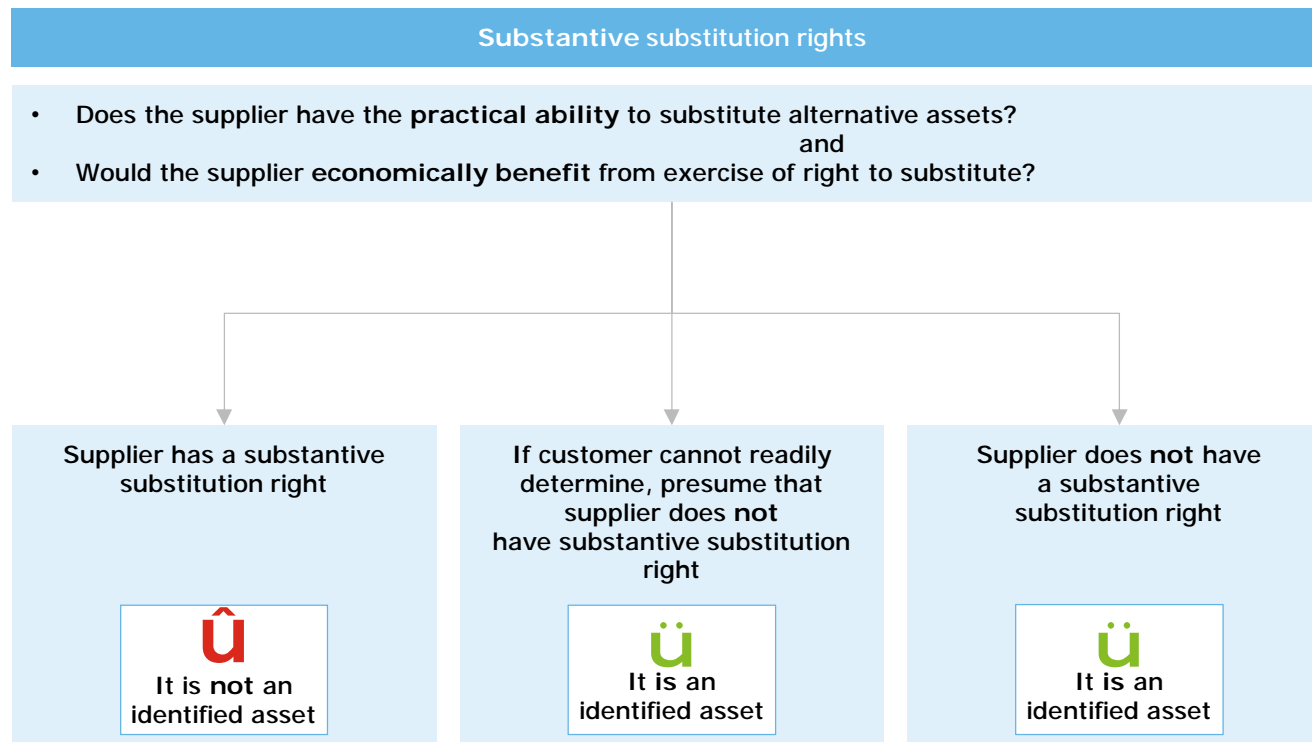


Identified asset (cont'd)

Portions of assets

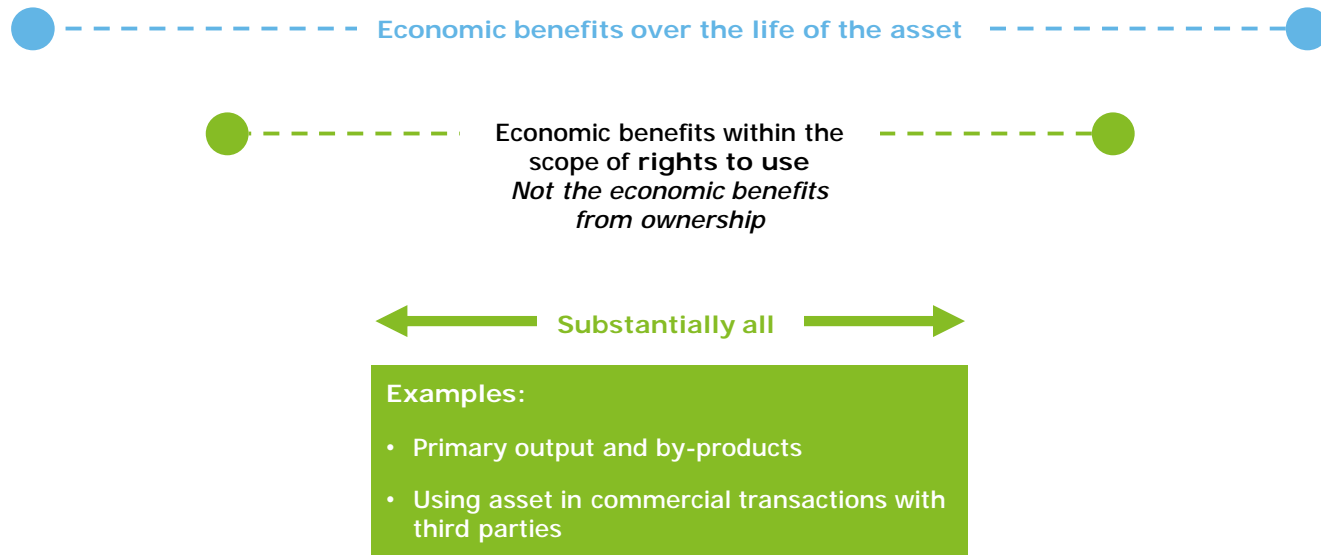


Identified asset (cont'd) Substitution rights of supplier



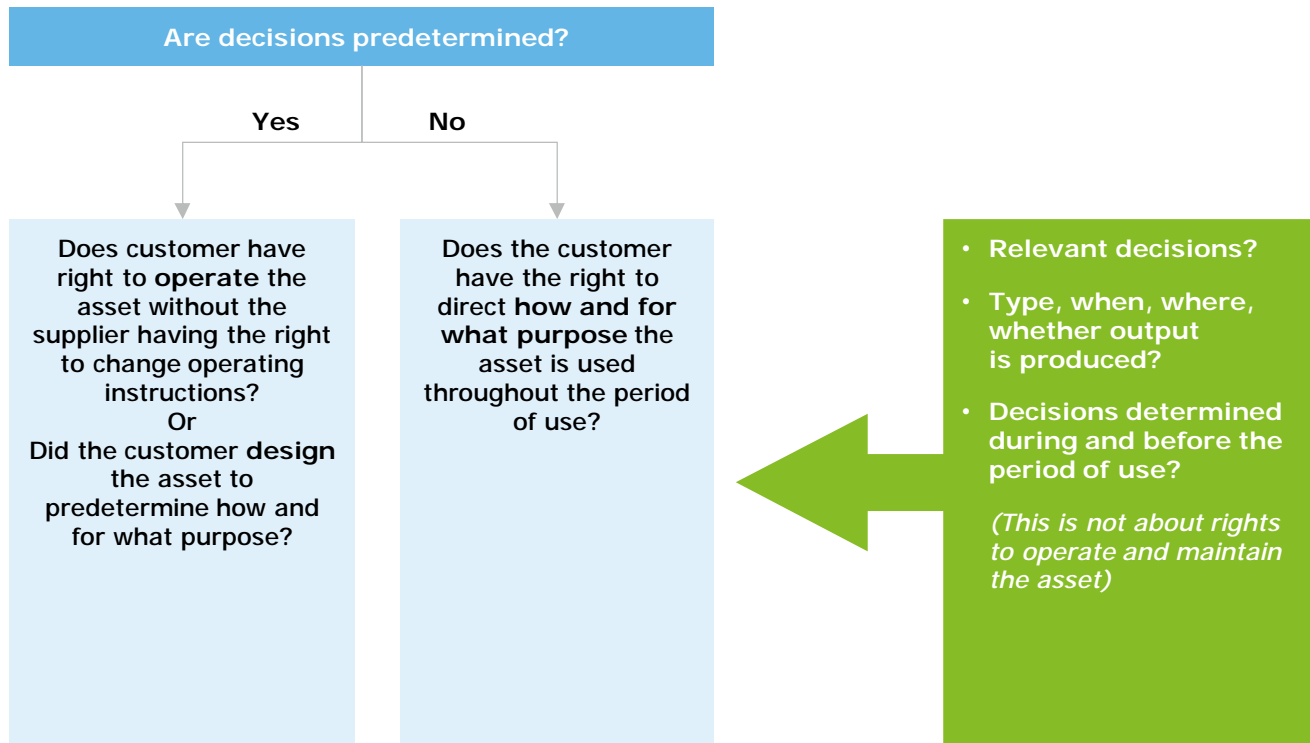
Control the use of the identified asset

Right to obtain economic benefits



Control the use of the identified asset

Right to direct the use



Example-Identified asset

Example
<p>A contract between Customer and Supplier requires Supplier to supply a truck (Plate # 2456) for a period of one year. Customer hired driver for the truck.</p> <p>The value of the truck is US\$3,500 and Supplier cannot change the truck unless repair and maintenance is needed.</p>
Is there an identified asset?
Yes. The contract specifies a truck.
Is there a substantive right to substitute the assets ?
No. Supplier cannot change the truck anytime.
Does the customer have the right to direct the use of the identified asset?
Yes.
Is there a lease ?
Yes. It is a lease. BUT, customer can apply the exemption of short term lease.

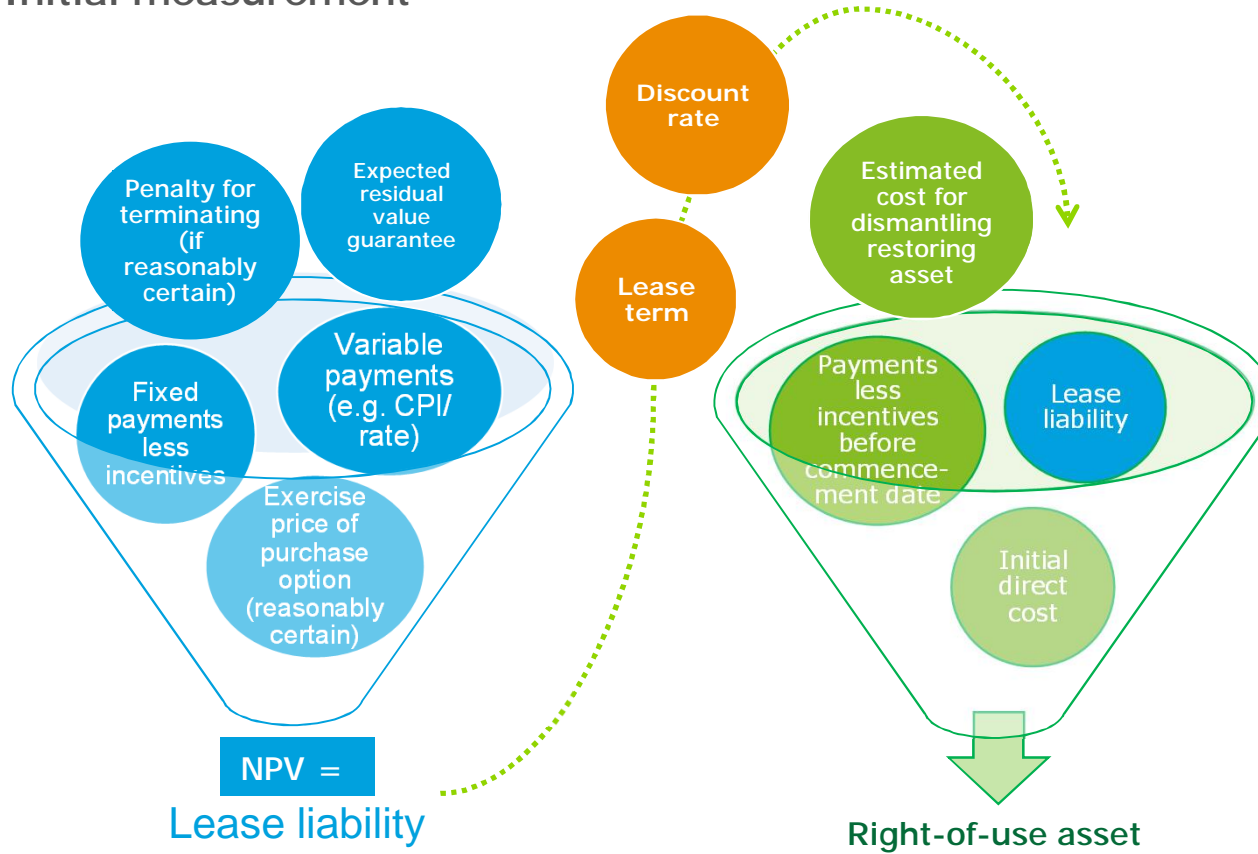
HKFRS 16

How should we calculate
the lease assets and
liabilities?



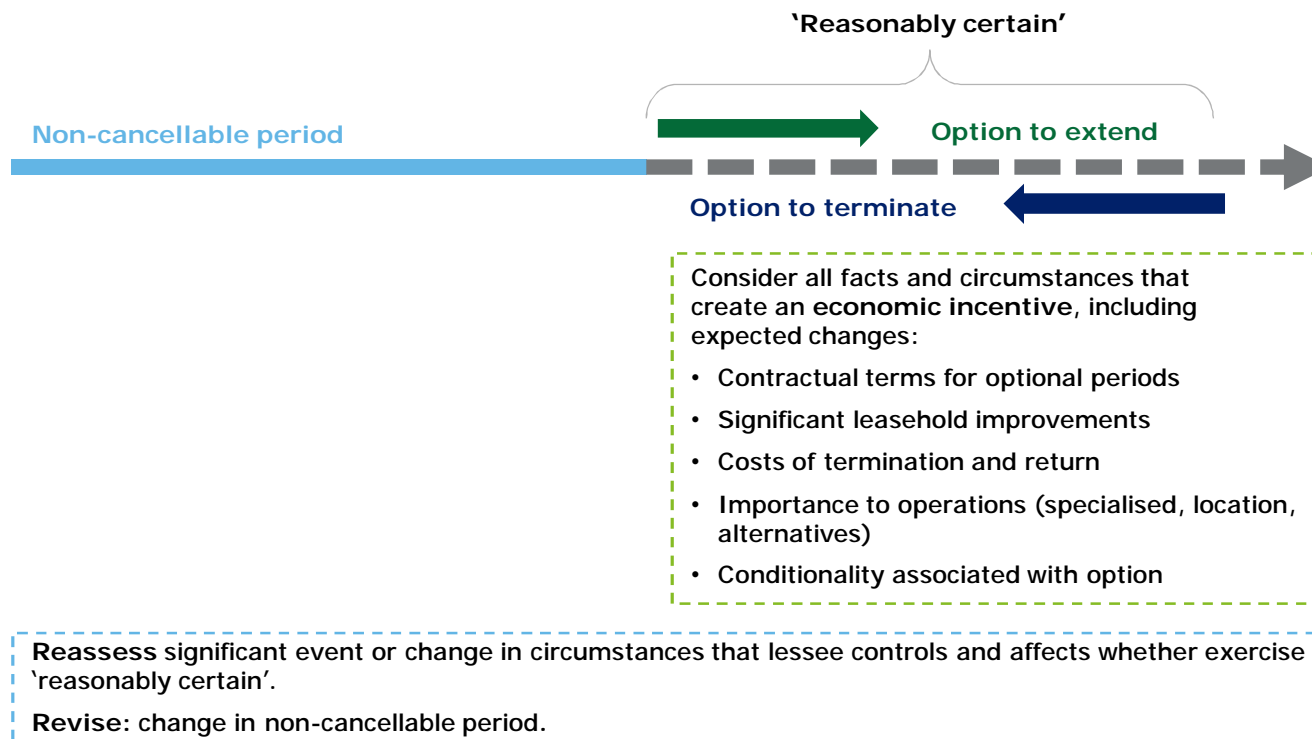
Measurement

Initial measurement



Lessee accounting (cont'd)

Lease term extension and termination options



Lessee accounting (cont'd)

The discount rate

Interest rate implicit in the lease

The rate of interest that causes the present value of

- (a) the lease payments and
- (b) the unguaranteed residual value to equal the sum of
 - (i) the fair value of the underlying asset and
 - (ii) Any initial direct costs of the lessor.

Incremental borrowing rate

The rate of interest that a lessee would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment.

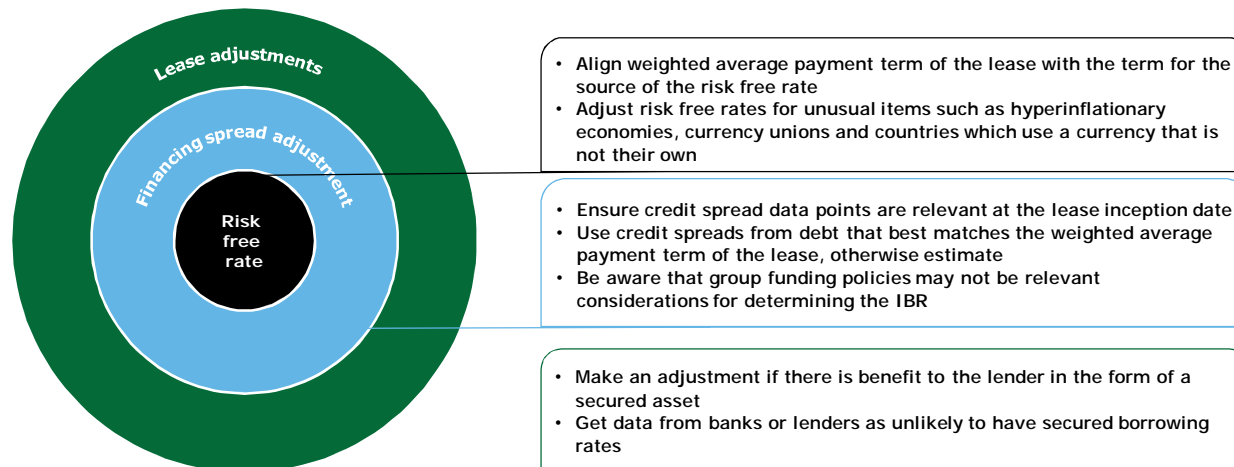
Determining appropriate discount rates

- The interest rate implicit in the lease should be used if it can be readily determined; otherwise, use the incremental borrowing rate.
- Determining the rate implicit in the lease requires knowledge of the underlying asset's residual value and its fair value; information unlikely to be readily available to lessees.
- Property yields can potentially be used as a starting point for determining an incremental borrowing rate.
- There will still be considerable judgement as to what particular adjustments will need to be made and it may require occupiers to understand more about the alternative use value of their estate to do so.

Discount rate

How to calculate an incremental borrowing rate

IBR methodology thoughts



Lessee accounting

The discount rate

Why does it matter?

Example fact pattern:

- On 1 Jan 2020, a company enters into 700 new 10-year leases with rentals of HK\$48,000 each per year paid in arrears.
- Under IAS 17 it would have recognised a straight-line expense of HK\$33.6m per year.

Discount rate	5%	7%	10%
Initial liability	\$259m	\$236m	\$206m
Year 1 expense	\$39m	\$40m	\$41m
Year 5 expense	\$34m	\$35m	\$35m
Year 9 expense	\$29m	\$28m	\$26m
Total payable	\$336m	\$336m	\$336m

Measurement

Initial measurement: Example

Initial Direct Cost	T ₁	T ₂	T ₃	T ₄	T ₅
100	250	300	350	400	450



Lease term : 5 years

Discount rate : 5%

Present Value = 1,494

Lease liability 1,494

Right of use asset 1,594 (1,494 + 100)

Measurement Subsequent measurement

HKFRS 16 :

Year	Lease Liability Depreciation Table		
	Principal	Interest	Rental
T1	1,494	75	250.00
T2	1,319	66	300.00
T3	1,085	54	350.00
T4	789	39	400.00
T5	429	21	450.00

Year	Asset Depreciation Table		
	Beg. Bal	Depreciation	End. Bal
T1	1,594	319	1,275
T2	1,275	319	956
T3	956	319	638
T4	637	319	319
T5	319	319	0.00

HKAS 17 :

$$(250+300+350+400+450)/5 = 350/\text{year}$$

Lease term : 5 years

Discount Rate : 5%

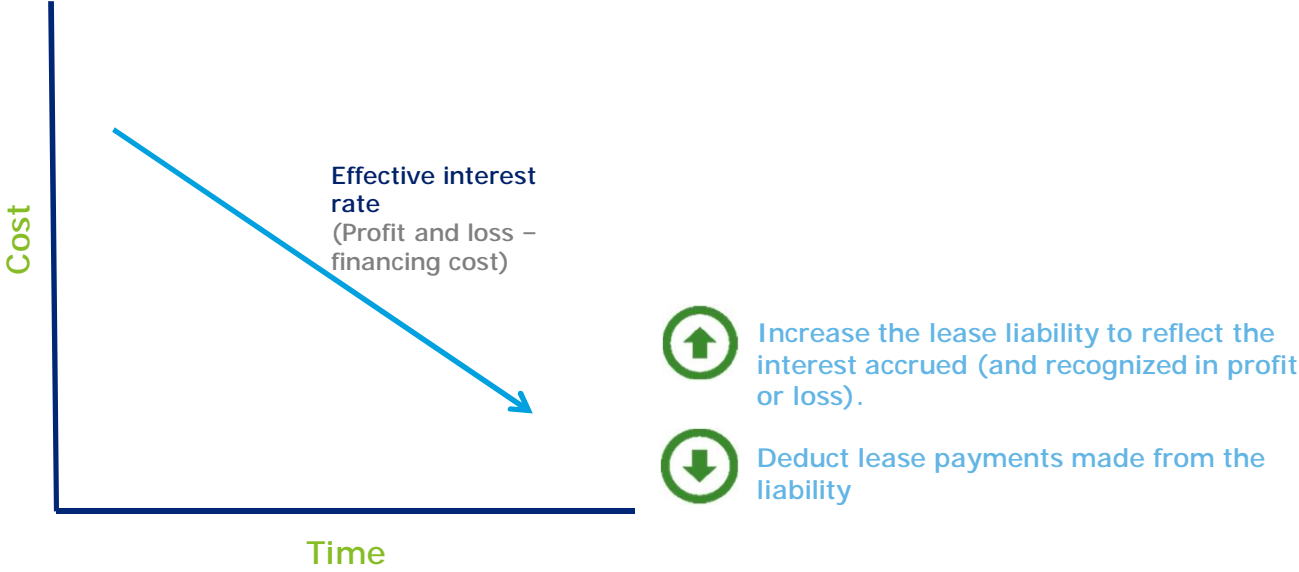
Present Value	1,494
=	

Lease Liability 1,494

Right of use asset 1,594 (1,494 + 100)

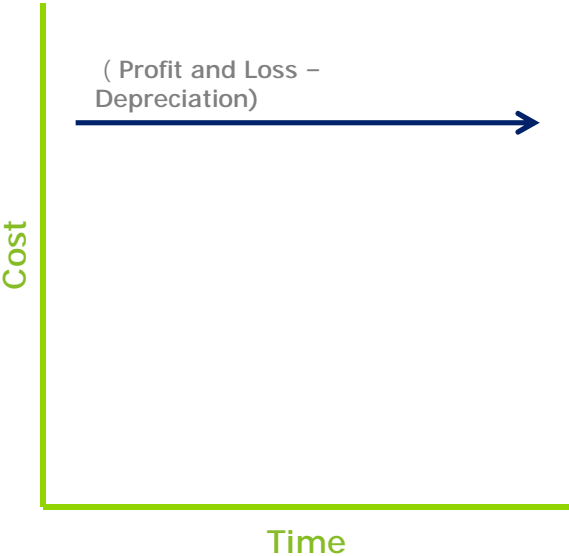
Measurement




Subsequent measurement: Lease liability



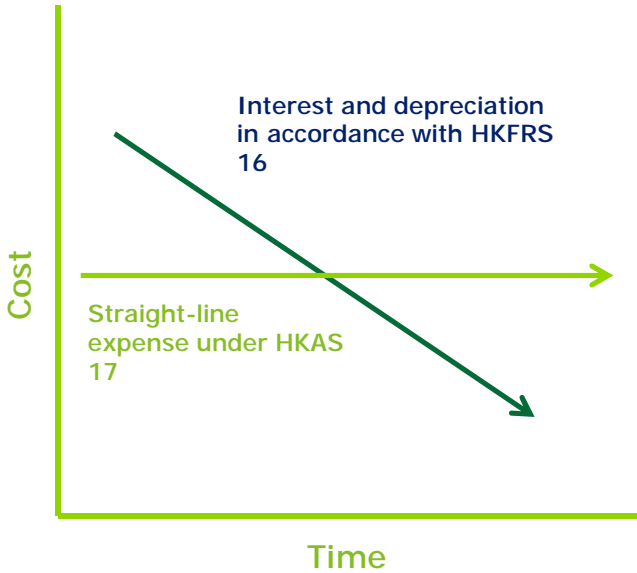
Measurement

Subsequent measurement: Right of use asset



-  Apply depreciation provisions in HKAS 16
-  Apply depreciation over the useful life (consider renew option)
-  Measuring impairment according to HKAS 36

Measurement HKAS 17 vs HKFRS 16



HKFRS 16 leads to recognition of more lease expenses in early periods of a lease

HKAS 17 unwinds the profit and loss impact

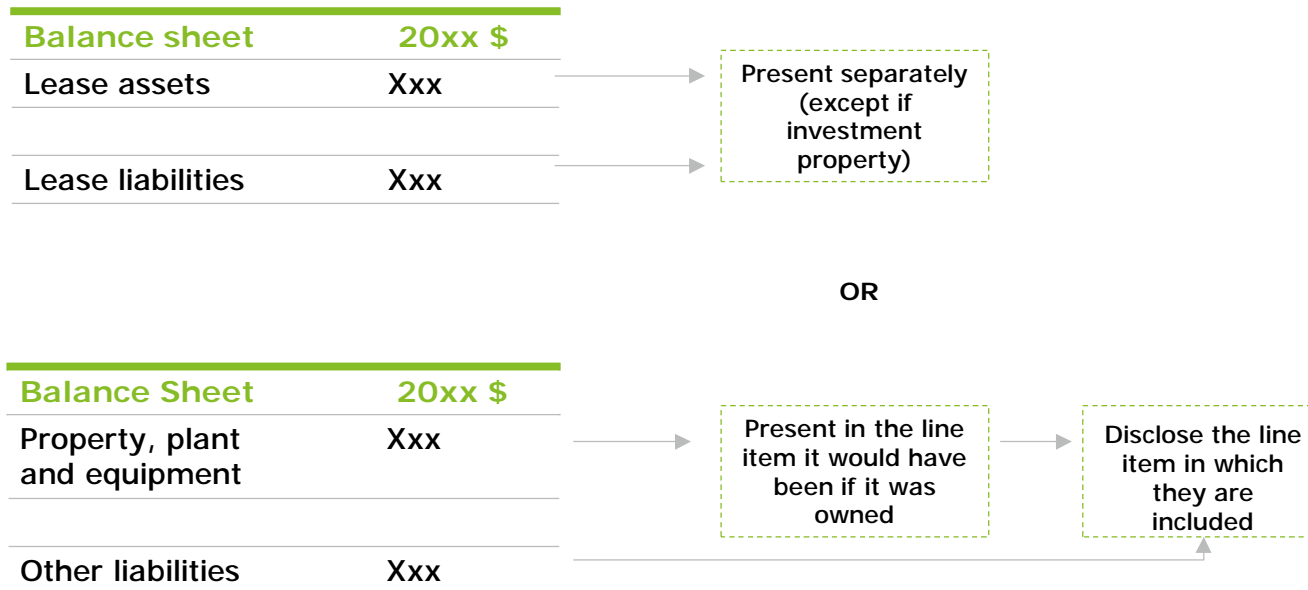
HKFRS 16

What are the additional
Disclosures under
HKFRS 16?



Presentation and disclosure

Balance sheet



Presentation and disclosure (cont'd)

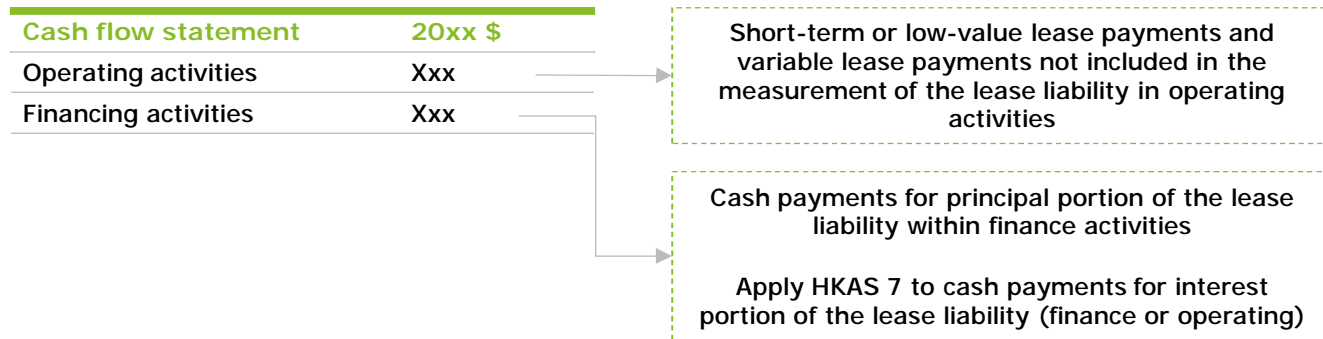
Income statement

Income statement	20xx \$
Variable lease payments, re-measurement gains/losses, short term, low value leases	Xxx
Depreciation	Xxx
Finance cost	Xxx
Profit before tax	Xxx

Present interest expense separate from depreciation
(Interest is a component of finance cost under HKAS 1)

Presentation and disclosure (cont'd)

Cash flow statement



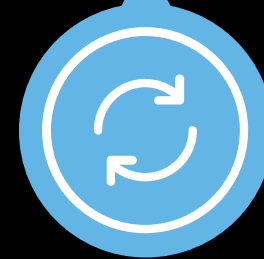
Presentation and disclosure (cont'd) In the notes

<p>Financial information</p> <ul style="list-style-type: none"> • Depreciation by class, interest expense • Low-value or short-term lease expenses (not < 1 month) • Variable lease payments • Income from subleases • Total cash flow • RoU asset: additions, carrying amount at end • Fact: low-value or short-term lease exemption
<p>Revalued RoU asset (HKAS 16)</p> <ul style="list-style-type: none"> • Effective date of revaluation • Whether independent valuation expert involved
<p>Lease liabilities</p> <ul style="list-style-type: none"> • Separate HKFRS 7 maturity analysis
<p>Qualitative and quantitative disclosures</p> <ul style="list-style-type: none"> • Nature of leasing activities, • Exposure to possible future cash outflows • Restrictions or covenants

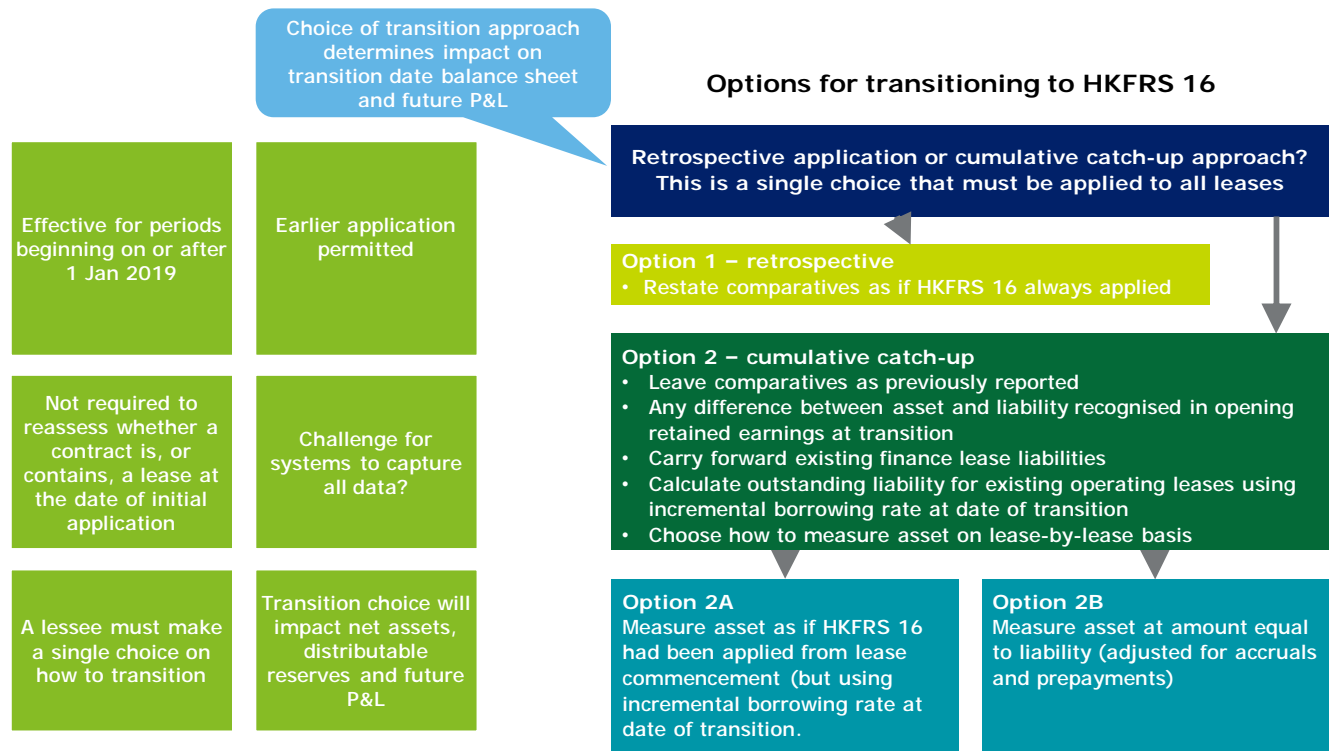


HKFRS 16

Should we restate our
financial statements upon
Adoption of HKFRS 16?



Lessee accounting Transition



Lessee accounting (cont'd)

Transition

Application of transition options – example

Example facts:

- 5-year lease, entered into on 1 Jan 2018; HK\$100k payable on second day of each year.
- 8% discount rate at lease commencement; 12% incremental borrowing rate at date of transition.
- Right-of-use asset is depreciated straight-line.

Option 1			
Date	Asset	Liability	Total expense
Lease commencement – 1 Jan 2017	431	431	
Year ended 31 Dec 2017	345	358	113
Year ended 31 Dec 2018	259	278	106
Amounts recognised at transition on 1 Jan 2019	259	278	
Year ended 31 Dec 2019	172	193	102
Year ended 31 Dec 2020	86	100	93
Year ended 31 Dec 2021	0	0	86
Total expense post-transition			281

Option 2A			
Date	Asset	Liability	Total expense
Lease commencement – 1 Jan 2017	404		
Year ended 31 Dec 2017	323		
Year ended 31 Dec 2018	242		
Amounts recognised at transition on 1 Jan 2019	242	269	
Year ended 31 Dec 2019	161	189	101
Year ended 31 Dec 2020	81	100	92
Year ended 31 Dec 2021	0	0	81
Total expense post-transition			274

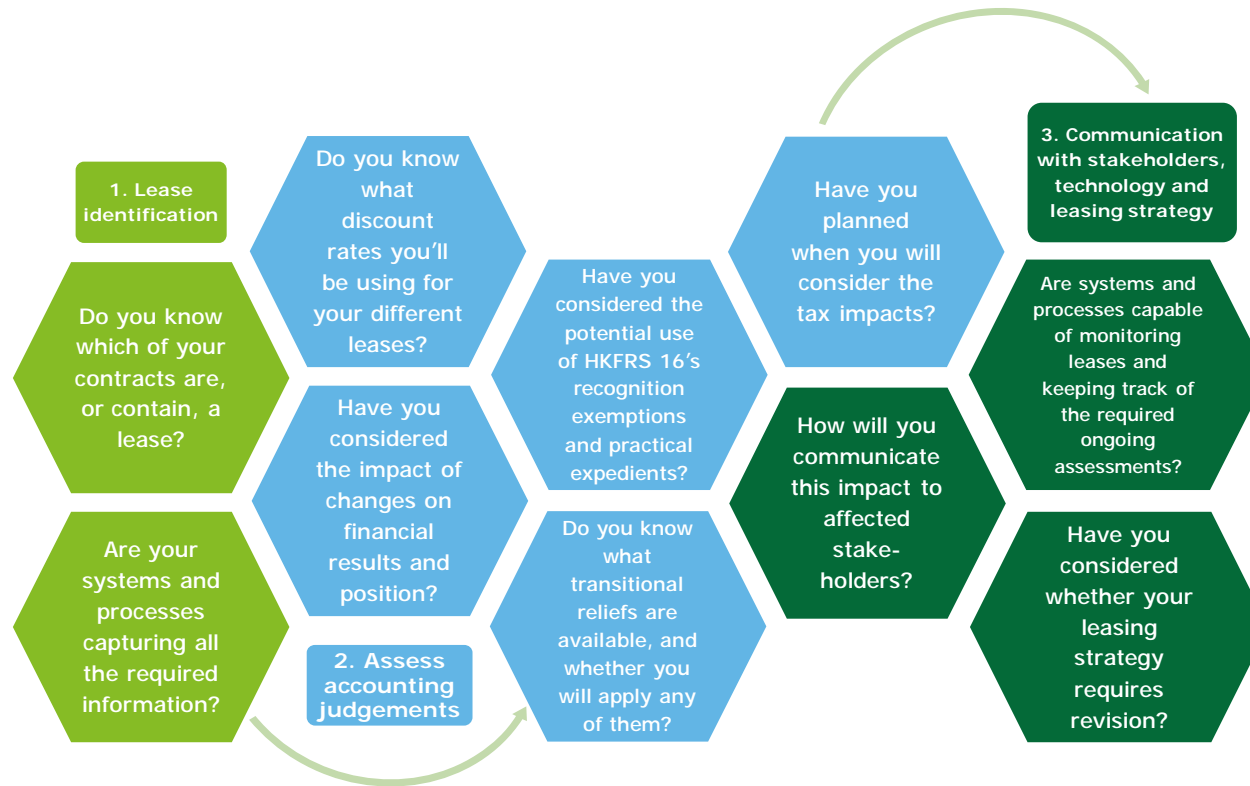
Option 2B			
Date	Asset	Liability	Total expense
Amounts recognised at transition on 1 Jan 2019	269	269	
Year ended 31 Dec 2019	179	189	110
Year ended 31 Dec 2020	90	100	100
Year ended 31 Dec 2021	0	0	90
Total expense post-transition			300

Are you ready?



Readiness

Preparing your plan



Questions & answers





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