



HKEx Guidance Letter on Disclosure of the Basis of Consideration and Business Valuation in Notifiable Transactions

In a financial landscape where precision and transparency are paramount, the Stock Exchange of Hong Kong Limited (the “**HKEx**”) has published a guidance letter (the “**Guidance Letter**”) on 20 October 2023 to address the concerns for the fairness and reasonableness of the terms of a transaction. In particular, the Guidance Letter emphasizes the need for listed companies to provide adequate explanation of the basis for determining the consideration of the transaction by disclosing sufficient and objective information with quantitative inputs and analysis to substantiate how the consideration was arrived at. The disclosure should be specific and not to be overly general and simplistic, allowing shareholders to understand how the valued amount was determined, and so as the consideration. The Guidance Letter provides guidance on the recommended disclosures and is divided into two sections. One for the disclosures in a business valuation report and the other for the transactions where no independent valuation is conducted.

Recommended Disclosures of Business Valuation Report

Under the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (the “**Listing Rules**”), when an issuer conducts an acquisition or disposal that constitutes a notifiable transaction and where the consideration of the transaction is determined with reference to an independent business valuation of the subject company (the “**Target**”), the disclosure document should contain the valuation report of the Target or summary of the valuer’s view and analysis, and all material factors considered in the valuation report, including at least the information about the effective valuation date, valuation approaches, scope and limitation of work, principal assumptions and key information adopted, conclusion of value, as well as the identity, qualification and independence of the valuer.

In the appraisal of the value of the Target, different valuation approaches may be adopted. Regardless of which approach is adopted, the reasons for the selection and the key inputs and assumptions need to be clearly disclosed, to the extent necessary for the shareholders to understand the valuation.

The following summarized the recommended disclosures of the key inputs and assumptions for different approaches by the Guidance Letter.

Market Approach	Income Approach
<ol style="list-style-type: none"> 1. Financial information of the Target; 2. Selection process and relevant criteria of the comparable companies, such as business nature, development stage, geographical location; 3. Relevant details of the comparable companies, including the nature and location of their principal businesses, financial information and quantitative benchmark such as the percentage of revenue or profits attributable to the relevant business segment; and 4. Details of the adopted pricing multiple, including the rationale of the selection, computation process, explanation on determining the excluded outliers and adjustments made for differences between the Target and the comparable companies, if any. 	<ol style="list-style-type: none"> 1. Detailed disclosure of key assumptions and quantitative inputs underlying the financial forecasts, including but not limited to revenue growth rates, the gross profit or EBITDA margin, changes in major expenses and plan for capital expenditure, and the respective forecast rationale; 2. Basis of determination of the key inputs in the discounted cash flow (“DCF”) model, such as discount rate and terminal growth rates; 3. Narrative descriptions of the DCF model and the computation process of the value of the Target; and 4. Sensitivity analysis for key assumptions or inputs that would materially affect the valuation.
Cost Approach	Asset-based Approach
<ol style="list-style-type: none"> 1. Quantitative inputs used to determine the gross current replacement or reproduction cost, including factors such as material, labor costs and other associated expenses; 2. Amount of depreciation adjustments made to account for physical deterioration and obsolescence; and 3. Computation process of the depreciated replacement or reproduction cost. 	<ol style="list-style-type: none"> 1. Appraised value and book value of each asset and liability of the Target, and their differences, together with the explanation for the differences if material; 2. Key quantitative inputs and assumptions adopted and the computation process; and 3. Separate valuation reports for the assets and liabilities, if applicable.



Transaction where there is no Independent Valuation

As suggested in the Guidance Letter, regardless of whether an independent valuation is obtained for a notifiable transaction, the issuer has to provide an adequate explanation of the basis for determining the consideration. Therefore, if the issuer does not engage an independent valuer to perform the business valuation, one should also adopt appropriate valuation methodology to assess the value of the Target, and the corresponding basis of determination of the consideration should be sufficiently documented in the disclosure documents in accordance with the recommended disclosures by the Guidance Letter.

How AVISTA can Help

While business valuation plays an indispensable role in an acquisition or a disposable transaction, the Listing Rules currently do not impose strict requirements for independent valuation for a notifiable transaction. On the other hand, as stressed in the guidance note on directors' duties in the context of valuations in corporate transactions issued by the Securities and Futures Commission (the "SFC") in May 2017, directors are responsible for determining whether the terms of the transaction, including the consideration to be paid, are fair and reasonable. Directors should therefore consider the need for a valuation to be conducted by an independent professional valuer if the directors do not themselves possess sufficient experience or expertise in either the field of business to which the asset or the Target belongs or in valuation as a whole. An independent professional valuer could aid the directors in assessing the reasonableness of the consideration by performing thorough analysis, which include but not limited to understanding the business of the Target, analyzing its financial performance, performing market research of the industry where the Target is operating, etc.

As a leading professional business valuation firm in Hong Kong, AVISTA has extensive financial knowledge and experience in business valuation for different industries. Our experienced professionals come from globally renowned valuation firms, consulting firms and international accounting firms with qualifications such as CPA, CFA, CPV, FRM and MRICS etc. Our valuation experts are ready to advise you on how to ensure compliance with regulators' stringent rules and disclosure requirements when implementing business decisions and strategies.

For further information or enquiries, please feel free to contact us.



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AVISTA Group ("AVISTA") is a leading professional advisory firm. We are experienced in performing a full range of Valuation Advisory, Risk Management Advisory, ESG Advisory, Corporate Advisory, and Property Consultancy services for various purposes. AVISTA is a corporate member of The International Valuation Standards Council (IVSC).

With a strong presence in the Asia-Pacific region, we have offices in Hong Kong, Shanghai, Beijing and Shenzhen. Through effective utilization of our local and international networks and the synergies among our service lines, we aim at providing high-quality services to clients and assisting clients in formulating strategies to maximize their value under complex business circumstances.

The AVISTA professional team comprises more than 100 professional consultants, each with different areas of expertise and detailed familiarity of financial reporting standards and regulatory standards. Our team of experienced professionals come from globally-renowned valuation firms, consulting firms and international accounting firms with global qualifications such as CFA, CPA, CPV, FRM, MRICS, FCCA and so on.



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