

Client Alert.

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New Hong Kong Listing Rules for Mining and Petroleum Companies

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Seeking to take advantage of vibrant commodity markets and challenge the dominance of Toronto, Sydney and other prominent listing venues for resource IPOs, the Hong Kong Stock Exchange (the "Exchange") recently amended Chapter 18 of its Listing Rules to facilitate listings in Hong Kong by mining and petroleum companies.

The Exchange has grown significantly in the last 10 years, with growth driven principally by financial, property and manufacturing listings. The Exchange was the top market in the world for IPOs in 2009, with over US\$31 billion raised in over 60 IPOs, and had a market capitalization of US\$2.2 trillion as of 30 June 2010. The Hong Kong market offers ample opportunities for follow-on fundraising, typically through undocumented primary and secondary block trades to institutional investors.

Recent years have seen a number of Chinese mining companies list on the Exchange. However, until now, any natural resources company keen to list in Hong Kong had to negotiate with the Exchange on a case-by-case basis, as the rules for listing mineral companies lacked clarity and certainty.

The recent amendments to the Listing Rules have clarified and updated the Listing Rules and synchronized them in certain important respects with globally recognized standards. In addition to listing applicants, the revised Chapter 18 also affects existing listed mineral companies, and other listed entities that acquire or dispose of mineral or petroleum assets that make up 25% or more of their existing activities.

This Client Alert provides an overview of the requirements of the new Chapter 18 of the Listing Rules.

KEY TAKEAWAYS

- Eligibility rules for mineral company listing applicants have been made, with the imposition of certain capitalization requirements and a disclosure regime covering working capital and operating costs (for those that have commenced production). Listing applicants that have not yet commenced production must set forth implementation plans for production with indicative dates and costs supported by an independent technical report by a Competent Person.
- The new Chapter 18 also requires independent technical reports from a "Competent Person" who must possess a minimum of five years' relevant experience together with professional qualifications and independence from the issuer.
- Chapter 18 has adopted internationally accepted reporting standards for disclosure of mineral reserves including the Australian, Canadian and South African mineral codes (the JORC, NI 43-101 and SAMREC Codes), the Petroleum Resources Management System and the Australian, Canadian and South African valuation codes (CIMVAL, SAMVAL and VALMIN). Although other standards may be used, reconciliation to one of the above standards is required. Notably, Russian and Chinese standards will not be accepted in the absence of reconciled reports.

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- Although Chapter 18 now provides an alternative qualifying route for those applicants who are unable to meet current financial track record requirements, early-stage exploration companies without identifiable mineral or petroleum reserves or resources will not be deemed to qualify as suitable listing candidates.
- The Exchange has in recent years added Australia and Canada (British Columbia and Ontario) to the list of acceptable overseas jurisdictions for listing applicants, which in combination with the new Chapter 18 makes a Hong Kong listing an attractive option for mining companies based in these jurisdictions.

The new rules treat as a ‘Mineral Company’ any company whose major activity (representing 25% or more of the total assets, revenue or operating expenses of the issuer and its subsidiaries), whether directly or through its subsidiaries, is the exploration for and/or extraction of minerals and/or petroleum (“Natural Resources”).

NEW CONDITIONS FOR LISTING (IN ADDITION TO THE USUAL FINANCIAL TRACK RECORD REQUIREMENTS)

RIGHTS TO EXPLORATION AND/OR EXTRACTION AND CONTROL OF ASSETS

The applicant must have the right to participate actively in exploration for and/or extraction of Natural Resources:

- through control of a majority (>50% by value) of the assets in which it has invested together with adequate rights over such exploration and/or extraction; or
- through adequate rights, which give it sufficient influence in decisions over such exploration and/or extraction.

“Adequate rights” include exploration and extraction rights held by third parties under joint, product sharing or other valid arrangements, if the applicant can demonstrate enough influence over the exploration and extraction.

Rights granted under specific government mandates will be recognized. If a company has not yet started production and cannot show it has extraction rights until later, the risks relevant to obtaining such rights must be disclosed.

PORTFOLIO

The applicant must at least have a meaningful portfolio of Indicated Resources of minerals (as defined in the Australasian Code for Reporting of Exploration Results, Mineral Resources and Ore Reserves (“**JORC Code**”)), or Contingent Resources of petroleum (as defined in the Petroleum Resources Management System (“**PRMS**”))

Early stage exploration companies or companies with only Inferred Resources are not eligible to list.

Pre-production mineral companies must also:

- outline their plans to proceed to production, with indicative dates and costs;
- be supported by a Scoping Study evaluating their mineral resources (including economic viability), to be substantiated by the opinion of a Competent Person.

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COMPETENT PERSON'S REPORT

The resources must be substantiated by an independent technical report under recognized reporting standards (see below). The report must be prepared by a Competent Person, being a person who:

- has appropriate professional qualification and is in good standing;
- has at least five years' relevant experience; and
- is independent of the applicant and its directors, senior management and advisers.

CASH OPERATING COSTS

If production has begun, an estimate of cash operating costs is required, such as workforce employment, consumables, non-income taxes and royalties as well as other governmental charges and contingency allowances.

WORKING CAPITAL REQUIREMENTS

Working capital must be at least 125% of budgeted working capital needs for the next 12 months.

REPORTING STANDARDS

The reporting standards acceptable to the Exchange are currently:

- the JORC Code, National Instrument 43-101 and the SAMREC Code (South African Code for the Reporting of Exploration Results, Mineral Resources and Mineral Reserves), for mineral resources and reserves;
- PRMS, for petroleum resources and reserves; and
- Canada's CIMVAL Code, South Africa's SAMVAL Code and Australasia's VALMIN Code, for valuations.

Where information is presented in accordance with other reporting standards, reconciliation to a JORC-type code must be provided, until the Exchange can recognise such other standards independently. (They must give a comparable standard of disclosure and sufficient assessment of the underlying assets.)

ALTERNATIVE ELIGIBILITY REQUIREMENTS FOR MINERAL COMPANIES THAT CANNOT MEET THE USUAL FINANCIAL TRACK RECORD REQUIREMENTS

OBTAINING A WAIVER OF THE USUAL FINANCIAL TRACK RECORD REQUIREMENTS

The financial track record requirements in Listing Rule 8.05 can be waived if the Mineral Company can satisfy the Exchange that its directors and senior managers, taken together, have sufficient experience relevant to the exploration and/or extraction activity that it is pursuing.

Individuals relied on must have a minimum of five years' relevant industry experience.

Applicants that are already in production will usually need a demonstrable path to profitability.

For example, a Mineral Company incurring expenditure on further exploration or development activities which have contributed to the inability to meet the profit requirements is likely to be considered favorably for a waiver.

However, a Mineral Company unable to meet the profit requirements with all of its mining assets in operation and no development activity on hand will not be able to seek a waiver. Again, no waiver is likely where a Mineral Company has made losses attributable to suppressed commodity prices, and is relying purely on a recovery of prices to turn profitable in the future.

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ADDITIONAL PROSPECTUS DISCLOSURE REQUIREMENTS

Prospectus disclosure must comply with the following:

RISK FACTORS AND RISK ANALYSIS

Risk disclosure should have regard to a new Guidance Note 7, which provides a framework for rating risks based on likelihood and consequence.

COMPETENT PERSON'S REPORT: NO MATERIAL CHANGE

State that no material changes have occurred since the effective date of the Competent Person's Report.

DESCRIPTION OF RIGHTS AND PROPERTIES

State nature and extent of the applicant's prospecting, exploration, exploitation, land use and mining rights and a description of the relevant properties, including duration and other principal terms and conditions of concessions and any necessary licenses and consents.

CLAIMS AND PROCEEDINGS

State any legal claims or proceedings that may influence the applicant's rights to explore or mine.

FURTHER INFORMATION

If relevant and material to the business operations, set out information on the following:

- a. project risks arising from environmental, social, and health and safety issues, and environmental liabilities of the applicant's projects or properties;
- b. any non-governmental organization impact on sustainability of mineral and/or exploration projects;
- c. compliance with host country laws, regulations and permits, and payments made to host country governments in respect of tax, royalties and other significant payments, on a country by country basis;
- d. sufficient funding plans for remediation, rehabilitation, closure and removal of facilities in a sustainable manner;
- e. the applicant's historical experience of dealing with host country laws and practices, including management of differences between national and local practice;
- f. the applicant's historical experience of dealing with concerns of local governments and communities on the sites of its properties, and relevant management arrangements; and
- g. any ancestral, native or other claims that may exist over the land on which exploration or mining activity is being carried out.

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IMPACT OF THE NEW LISTING RULES ON LISTED ISSUERS

- A listed issuer that completes a major (or above) acquisition of assets that are wholly or mainly Natural Resources will become a Mineral Company and must include a Competent Person's Report and valuation report in the relevant circular. (A "major (or above)" transaction refers to a transaction in which any of the applicable assets, profits, revenue, consideration or equity capital ratios ("**percentage ratio**") under the Listing Rules is 25 per cent or more).
- A listed issuer that publicly discloses details of mineral/petroleum resources and/or reserves after implementation of these new Listing Rules must update such details once a year in its annual report.

CONTINUING OBLIGATIONS OF LISTED MINERAL COMPANIES

Listed Mineral Companies must provide the following information:

- Annual updates of resources and/or reserves, presented in tables and in a manner readily understandable by laymen.
- Half-yearly disclosures in the interim and annual reports:
 - details of the exploration, development and mining production activities; and
 - a summary of expenditures incurred on these activities during the review period.
- For any major (or above) acquisition of assets that are wholly or mainly Natural Resources, a Competent Person's Report and valuation report in the shareholder circular.
- On making a major (or above) disposal of assets that are wholly or mainly Natural Resources, a Competent Person's Report and details of any material liabilities that remain.

For further information, please approach your usual contact at Morrison & Foerster, or contact:

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