Right Issue and Open Offer in Hong Kong

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Conceptual Differences between a Rights Issue and an Open Offer

Rights Issue

- An offer by way of rights to existing holders of securities which enables those holders to subscribe securities **in proportion** to their existing holdings (MB Rule 7.18).
- Rights issues are normally required to be conveyed by **renounceable provisional letters of allotment** or other negotiable instrument (MB Rule 7.20).
- The rights offered to an existing shareholder are normally traded as separate temporary securities from the parent share, commonly referred to as nil paid rights (**NPR**).

Open Offer

- An offer to existing holders of securities to subscribe securities, **whether or not in proportion** to their existing holdings, which are not allotted to them on renounceable documents (MB Rule 7.23).
- The rights offered to an existing shareholder under an open offer **cannot** be traded on the open market.
- Shareholders can either take up and exercise the rights to purchase new shares at the offer price, or allow the rights to lapse upon expiration.

Practical Differences between a Rights Issue and an Open Offer

Example of a rights issue

- Mr. X owns 1,000 shares in Company A with each share trading at HK$2 on the stock exchange.
- Company A currently:
  - has 1,000,000 shares in circulation (i.e. with market capitalisation of HK$2,000,000);
  - needs to raise HK$375,000 (before expenses); and
  - proposes to issue 250,000 new ordinary shares
- Existing shareholders are offered the right to purchase 1 new share in Company A for every 4 shares they currently hold (ie a 1:4 Rights Issue).
- The new shares are offered to the existing shareholders at a discounted price of HK$1.5 (HK$375,000 / 250,000).

Practical Differences between a Rights Issue and an Open Offer (cont'd)

Example of a rights issue (cont'd)

- The share price adjusts proportionately:
  - Price before the rights issue is **HK$2** per share.
  - Typically, when a company makes a rights issue one can expect the market value of the shares to fall as they are increasing the number of shares in circulation.
  - Initial shares in circulation = 1,000,000 shares @ HK$2 = HK$2,000,000
  - After rights issue = (1,000,000 x HK$2) + (250,000 x HK$1.5) = HK$2,375,000 / number of shares in issue.
  - Theoretical ex-rights price per share = £2,375,000/1,250.000 = **HK$1.9**

Practical Differences between a Rights Issue and an Open Offer (cont'd)

Options for existing shareholders in a rights issue

Accept in full or in part

- By exercising in full all the rights entitlements offered under the rights issue, the shareholder can maintain his proportionate ownership in the company with the enlarged share capital without experiencing shareholding dilution.
- In the case of a discounted rights issue, the stock market will, on the Ex-Date, price into the share price the effect of shareholding dilution as a result of the new additional shares issued.
- Once the shares are traded on ex-rights basis, the share price will drop to the theoretical ex-rights price (i.e. HK$1.9 in the example).
- However, this loss as a result of a fall in market share price is offset by the gain made when Mr. X subscribed the new shares at HK$1.5, a 25% discount to the market price of HK$2 per share trading on cum-rights basis.

Practical Differences between a Rights Issue and an Open Offer (cont'd)

Options for existing shareholders in a rights issue (cont'd)

Decline the offer, allowing the NPR to lapse upon expiration

- By allowing the rights entitlements to lapse upon expiration, the shareholder's stake in the company will be diluted together with a reduction in the value of his shareholdings following the conclusion of the rights issue.

Renounce and trade the NPR

- The shareholder's stake in the company will be diluted.
- However, the shareholder can gain by selling his rights entitlements away in the open market to compensate for the fall in value of his shareholdings.

Estimated value of NPR

= Theoretical ex-rights price – new shares offer price

= HK$1.9 – HK$1.5

= HK$0.4 per rights entitlement

Practical Differences between a Rights Issue and an Open Offer (cont'd)

- From the company's perspective, open offers may be cheaper as shares are usually offered at a finer discount than on a rights issue.

- From the shareholders' perspective, open offers do not allow them to gain from the tradable NPR in case they do not wish to subscribe for the new shares.

- Where companies seek to raise a substantial amount through an equity issue, they are more likely to use a rights issue than an open offer due to greater investor familiarity with rights issues and the greater flexibility they offer shareholders.

Procedural Differences between a Rights Issue and an Open Offer

	Rights Issue	Open Offer
Listing document	Publication of a prospectus which: • states, inter alia, the basis of subscription, the reason for the issue, the use of proceeds • contain contents as set out in Part B of Appendix 1 of the Listing Rules (but excluding paragraphs 8, 24, 26(1), (3)-(5) and 43(4)) • shall include a statement from each substantial shareholder as to whether that substantial shareholder has undertaken to take up its entitlement in full or in part and on what conditions, if any, and relevant particulars. • will be registered with the Companies Registry in accordance with the Companies Ordinance	Same as rights issue (see Main Board Rules 11.09(2)).

Procedural Differences between a Rights Issue and an Open Offer (cont'd)

	Rights Issue	Open Offer
Underwriting	Normally fully underwritten unless the prior consent of the HKEx to do otherwise has been obtained • HKEx may permit rights issue which is not underwritten in certain circumstances (e.g. where additional costs of underwriting are not justified in particular circumstances; or where an underwriting commitment was terminated by a force majeure event after offer opened; or to facilitate fund-raising by very substantial companies) subject to compliance with additional disclosure requirements ○ the fact that the rights issue is not fully underwritten; ○ the minimum amount, if any, that must be raised before the issue will proceed; ○ the intended application of net proceeds of issue according to the level of subscriptions	Same as rights issue except that there is no additional disclosure requirement in case underwriting could be terminated on occurrence of force majeure events after dealings of rights in nil-paid form has commenced (see Main Board Rules 7.24(1), 7.24(2), 7.24(3) & 7.24(4)).

Procedural Differences between a Rights Issue and an Open Offer (cont'd)

	Rights Issue	Open Offer
Underwriting (Cont'd)	• additional disclosures (including risk disclosures) must be included in listing document if underwriting could be terminated on occurrence of force majeure events after dealings of rights in nil-paid form have commenced • if a rights issue is not fully underwritten, a substantial shareholder who applies to take up its full entitlement may unwittingly incur an obligation to make a general offer under the Takeovers Code unless a waiver from the Executive is obtained. If this is likely to occur, the issuer may permit the substantial shareholder to scale-down its commitment in the case that the issue is not fully taken up to avoid a general offer obligation	Same as rights issue except that there is no additional disclosure requirement in case underwriting could be terminated on occurrence of force majeure events after dealings of rights in nil-paid form has commenced (see Main Board Rules 7.24(1), 7.24(2), 7.24(3) & 7.24(4)).

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Procedural Differences between a Rights Issue and an Open Offer (cont'd)

	Rights Issue	Open Offer
Underwriting (Cont'd)	• if not fully underwritten by a person or persons whose ordinary course of business includes underwriting, the listing document must contain full disclosure of that fact	Same as rights issue except that there is no additional disclosure requirement in case underwriting could be terminated on occurrence of force majeure events after dealings of rights in nil-paid form has commenced (see Main Board Rules 7.24(1), 7.24(2), 7.24(3) & 7.24(4)).

Procedural Differences between a Rights Issue and an Open Offer (cont'd)

	Rights Issue	Open Offer
Where the issued share capital or market capitalisation will increase by more than 50% (taking into account rights issues & open offers announced (i) in the previous 12 months or (ii) earlier where dealing in shares issued commenced in the previous 12 months)	There are additional applicable Listing Rules requirements which include: • **independent shareholders' approval**: the approval of independent shareholders in general meeting would need to be obtained where controlling shareholders and their associates (or where there is no controlling shareholder, the directors (other than INEDs) and the chief executives) must abstain from voting in favour of the resolution approving the rights issue (Main Board Rule 7.19(6)) • independent board committee must be established to advise shareholders as to terms of rights issue and whether they are fair and reasonable and how they should vote – a statement of the committee must be included in the circular	Same as rights issue (see Main Board Rules 7.24(5), 7.24(8))

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Procedural Differences between a Rights Issue and an Open Offer (cont'd)

	Rights Issue	Open Offer
Where the issued share capital or market capitalisation will increase by more than 50% (Cont'd)	• independent financial adviser must be appointed to make recommendations to the independent board committee – a statement of the adviser must be included in the circular • **<u>additional disclosures</u>**: the circular to shareholders must include descriptions of the purpose of proposed rights issue, the total funds expected to be raised, detailed breakdown and description of proposed use of proceeds of the current issue and in respect of any equity issues in the preceding 12 months	Same as rights issue (see Main Board Rules 7.24(5), 7.24(8))

Procedural Differences between a Rights Issue and an Open Offer (cont'd)

	Rights Issue	Open Offer
Provisional letters of allotment	Renounceable provisional letters of allotment, letter of rights or other negotiable instrument for all shareholders: • provisional allotment letters inform shareholders of the number of shares provisionally allotted to them • letter of rights informs shareholders that they have the right to buy a specific number of new shares at a specific price • any such letters must state the time, being not less than 10 business days, during which the offer may be accepted	By reason of the nature of open offers, this requirement is not applicable.

Procedural Differences between a Rights Issue and an Open Offer (cont'd)

	Rights Issue	Open Offer
Shares in excess	An issuer can make arrangements to dispose of rights shares not taken up by present shareholders – this can be done either by: • issuing excess application forms to shareholders along with provisional allotment letters to enable shareholders to subscribe for additional shares in the company *(excess shares must be available for subscription by all shareholders and allocated on a fair basis)*; or • selling the excess shares in the market, if possible, for the benefit of the persons to whom the rights shares were offered. (Main Board Rule 7.21(1))	An issuer can make arrangements to dispose of shares not applied for by allowing applications for excess shares *(these must be available for subscription by all shareholders and allocated on a fair basis).* (see Main Board Rule 7.26(A)). Offers of excess shares and the basis of allocation must be disclosed in the open offer announcement, listing document and any circular.

Procedural Differences between a Rights Issue and an Open Offer (cont'd)

	Rights Issue	Open Offer
Shares in excess (Cont'd)	❖ Offers of excess shares and the basis of allocation must be disclosed in rights issue announcement, listing document and circular. ❖ If no arrangements or arrangements other than those described above have been made for disposal of rights shares not taken up, and the rights issue is wholly or partly underwritten or sub-underwritten by a director, chief executive or substantial shareholder or their associates, then the absence of such arrangements or the making of other arrangements must be approved by the issuer's independent shareholders.	Listing Rules do **not** provide for issuers to sell the excess shares in the market for the benefit of the persons to whom the open offer was made. Independent shareholders' approval is required if no arrangements or arrangements other than those described above are made for disposal of shares not taken up if the open offer is underwritten or sub/underwritten by a director, chief executive or substantial shareholder (or their associates).

Procedural Differences between a Rights Issue and an Open Offer (cont'd)

	Rights Issue	Open Offer
Excluded shareholders	General rule under Main Board Rule 13.36 is that a **pro rata** rights issue does not require shareholders' approval. Main Board Rule 13.36(2)(a) allows issuers to exclude shareholders resident outside Hong Kong from the rights issue where: • the issuer has made enquiries regarding the legal restrictions under the laws of the relevant place and requirements of relevant regulatory body or stock exchange; and • based on those enquiries, the issuer's directors consider it necessary or expedient not to offer the rights shares to overseas shareholders.	Same as rights issue.

Procedural Differences between a Rights Issue and an Open Offer (cont'd)

	Rights Issue	Open Offer
Excluded shareholders (cont'd)	Usually, a legal opinion from overseas counsel in relevant jurisdictions is required for the directors to form such a view and pass resolutions accordingly approving the exclusion of certain overseas shareholders. If overseas shareholders are excluded under MB Rule 13.36(2)(a), an explanation for the exclusion must be included in the relevant circular or document containing the offer. Issuers should also deliver the circular or offer document to excluded shareholders for information, subject to compliance with local laws and regulations. If an issuer has shareholders in a large number of overseas jurisdictions, it may not be practical to obtain legal opinions from all relevant jurisdictions. Shareholders' approval will be required if the issuer will exclude overseas shareholders without obtaining legal opinions for all relevant jurisdictions.	Same as rights issue.

Procedural Differences between a Rights Issue and an Open Offer (cont'd)

	Rights Issue	Open Offer
Offer period	The offer period during which the rights shares may be accepted must be at least 10 business days. Where an issuer proposes an offer period of more than 15 business days, e.g. where there are a large number of overseas shareholders, the Exchange must be consulted. (Main Board Rule 7.20)	Same as rights issue (see Main Board Rule 7.25).
Closure of books	An issuer must announce any closure of its transfer books or register of members in respect of securities listed in Hong Kong at least **6 business days** before the closure of books. (Main Board Rule 13.66(1))	An issuer must announce any closure of its transfer books or register of members in respect of securities listed in Hong Kong at least **10 business days** before the closure of books. (Main Board Rule 13.66(1))

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Procedural Differences between a Rights Issue and an Open Offer (cont'd)

	Rights Issue	Open Offer
Last day for trading in the securities with entitlements	An issuer must ensure that the last day for trading in the securities with entitlements falls at least 1 business day after the general meeting, if the entitlements require the approval of shareholders in the general meeting or are contingent on a transaction that is subject to the approval of shareholders in the general meeting. In addition, for a rights issue, the issuer must provide at least 2 trading days for trading in the securities with entitlements (i.e. before the ex-date) after publication of the book closure.	Same as rights issue save that there is no requirement for 2 trading days for trading in the securities with entitlements after publication of the book closure (see Main Board Rule 13.66).

Procedural Differences between a Rights Issue and an Open Offer (cont'd)

	Rights Issue	Open Offer
Shareholders' meeting	General rule under Main Board Rule 13.36 is that a **pro rata** rights issue does not require shareholders' approval. As stated above, shareholders' approval will be required if: i) the rights issue will increase the issued share capital or market capitalisation by more than **50**% (either alone or when aggregated with rights issues or open offers announced in the previous 12 months or earlier where dealing in the new shares started in the previous 12 months);	Same as rights issue. However, where an open offer is made to existing shareholders **not in proportion** to their existing shareholdings, shareholders' approval in general meeting will be required unless the issuer will issue the offer shares under a general mandate in accordance with Main Board rule 13.36(2).

Procedural Differences between a Rights Issue and an Open Offer (cont'd)

	Rights Issue	Open Offer
Shareholders' meeting (cont'd)	ii) no arrangements or arrangements other than those in MB Rule 7.21(1) are made for the disposal of rights shares not taken up and the rights issue is wholly or partly underwritten or sub-underwritten by a director, chief executive or substantial shareholder of the issuer; or iii) where overseas shareholders are to be excluded (unless the conditions specified in MB Rule 13.36(2)(a) are met)	The general mandate cannot exceed 20% of the issued share capital of the issuer at the date of the general mandate. The shareholders can also separately authorise the issuer to issue shares equivalent to the number of shares repurchased since the date of the general mandate (up to a maximum number equivalent to 10% of the existing issued share capital)

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General Mandates

- The Listing Rules generally require shareholders' prior approval in general meeting for any allotment, issue or grant by an issuer of shares, securities convertible into shares or options, warrants or similar rights to subscribe for shares or such convertible securities (MB Rule 13.36(1)(a))
- Shareholders' approval is not generally required where the offer is made to all shareholders pro rata to their existing shareholdings (MB Rule 13.36(2)(a))
- Shareholders' approval is not required where the issuer's shareholders have by ordinary resolution in general meeting given a **general mandate** to the issuer's directors to allot or issue such securities (or grant options or warrants to subscribe for such securities) (MB Rule 13.36(2)(b))
- A general mandate is normally approved at the AGM and remains valid until the next AGM unless varied or revoked by ordinary resolution in general meeting.
- Shares cannot be issued to **connected persons** under a general mandate unless the connected transaction requirements under Chapter 14A are complied with.
- In the case of rights issues and open offers made **pro rata** to existing shareholders (which would not require reliance on a general mandate), securities issued to connected persons pro rata in their capacity as shareholders are **exempt** from the connected transaction requirements (MB Rule 14A.31(3)(a)).

Rights Issue Timetable (assuming no general meeting for shareholders' approval)

Event	Remarks	Timeline
Publication of the rights issue announcement (including timetable) on Exchange news website	At least six business days (i.e. five clear business days) before the book closure	Day 1 (Monday)
Last day of dealings in securities on cum-rights basis	The business day immediately before the ex-date.	Day 4 (Thursday)
Ex-date (the first day of dealings in securities on ex-rights basis)	There must be at least 2 uninterrupted trading days for trading cum-rights between the announcement of book closure and the ex-date.	Day 5 (Friday)
Days 6 & 7 (Saturday and Sunday) are not "business days"		

Rights Issue Timetable (assuming no general meeting for shareholders' approval)(cont'd)

Event	Remarks	Timeline
Latest time for lodging transfers of shares to qualify for the rights issue		4:30pm on Day 8 (Mon)
Register of members closes	Timetable assumes the register closes for 3 days	Days 9-11 (Tues- Thurs)
Record date for rights issue	Any day during the closure of the register of members period	Day 11 (Thurs)
Despatch of PALs		Day 12 (Fri)
Days 13 & 14 (Saturday and Sunday) are not "business days"		
First day of dealing in NPR	Two business days after the despatch of PAL	Day 16 (Tues)
Latest time for splitting of PAL	At least three working days before the last dealing day	Day 18 (Thurs)
Days 20 & 21 (Saturday and Sunday) are not "business days"		

Rights Issue Timetable (assuming no general meeting for shareholders' approval)(cont'd)

Event	Remarks	Timeline
Last day of dealings in NPR		Day 23 (Tues)
Latest time for acceptance and payment for rights shares and application for excess rights shares	• Three working days after last day for dealing NPR (to allow for settlement on T+2) • The offer period should not be less than 10 business days.	Day 26 (Fri)

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- Charltons is a firm with extensive experience in corporate finance and in-depth knowledge of Hong Kong law and practice
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- "**Asian Restructuring Deal of the Year**" 2000 awarded to Charltons by International Financial Law Review for their work with Guangdong Investment Limited.

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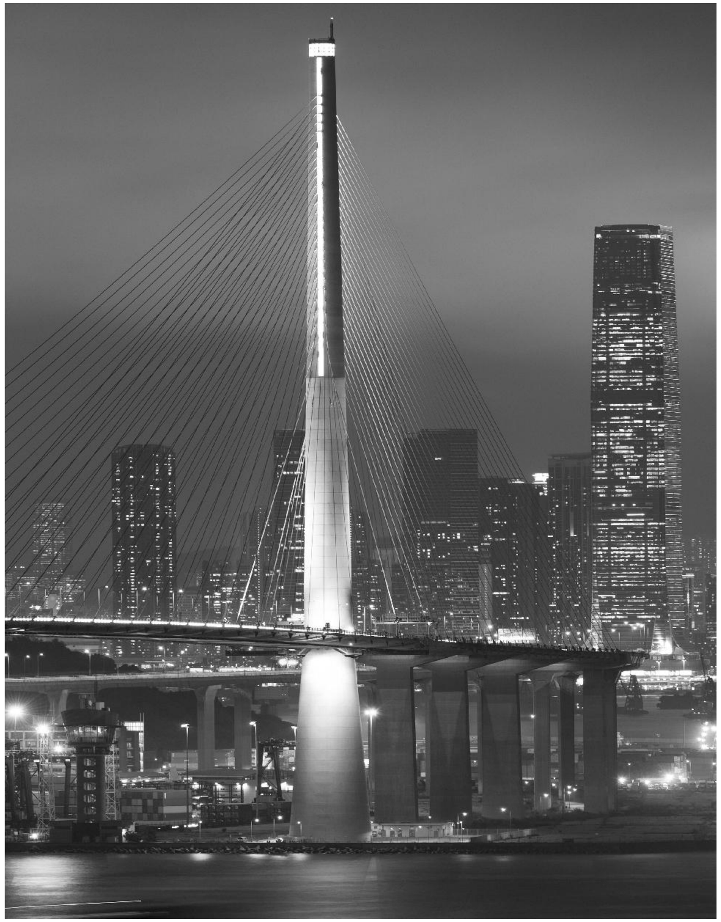

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