

HKEx LISTING DECISION
HKEx-LD95-1 (July 2010)

Parties	Company A – a Main Board issuer The Target – Company A’s acquisition target
Issue	Whether Company A would become a cash company as a result of its proposed placing of convertible notes Whether the Exchange would treat Company A’s proposed acquisition of the Target as a reverse takeover
Listing Rules	Main Board Rules 14.06(6) and 14.82
Decision	Company A would not be a cash company if it revised its proposal for placing convertible notes The Exchange did not treat the acquisition of the Target as a reverse takeover once Company A had complied with additional conditions

FACTS

- 1 Company A was principally engaged in security investments and manufacturing and trading battery products.
- 2 It announced a proposal to place new shares to independent placees to raise funds for general working capital and potential investment opportunities (the **First Placing**). The new shares represented over 30 times its existing share capital. Based on the information then available, Company A’s assets would substantially consist of cash upon completion of the placing and it would become a cash company under Rule 14.82.
- 3 Shortly after the announcement, Company A agreed to acquire the Target, an insurance company, from an independent vendor in cash (the **Acquisition**). This was a very substantial acquisition. The Target would be Company A’s subsidiary upon completion.
- 4 The Target’s total assets and turnover for its latest financial year exceeded \$300 billion and \$100 billion respectively. With an asset ratio of about 300 times and a revenue ratio of about 5,000 times, the Target was significantly larger than Company A. Thus, there was an issue whether the Acquisition should be treated as a reverse takeover under Rule 14.06(6).

- 5 To address the cash company issue, Company A decided not to proceed with the First Placing. Instead, it proposed to issue convertible notes to raise funds (the **Second Placing**) for the Acquisition. The notes would be redeemed within two weeks if the Acquisition fell through.
- 6 Company A submitted that Rule 14.06(6) should not apply to the Acquisition because:
- a. the Second Placing and the Acquisition would not result in a change in control of Company A; and
 - b. the vendor was not attempting to circumvent the new listing requirements. The sale was a forced sale by the vendor of its major assets with no pre-requisite as to the listing status of the purchaser.

APPLICABLE LISTING RULES

- 7 Rule 14.06(6) defines a “reverse takeover” as:

an acquisition or a series of acquisitions of assets by an issuer which, in the opinion of the Exchange, constitutes, or is part of a transaction or arrangement or series of transactions or arrangements which constitute, an attempt to achieve a listing of the assets to be acquired and a means to circumvent the requirements for new applicants set out in Chapter 8 of the Exchange Listing Rules. A “reverse takeover” normally refers to:

- (a) an acquisition or a series of acquisitions (aggregated under rules 14.22 and 14.23) of assets constituting a very substantial acquisition where there is or which will result in a change in control (as defined in the Takeovers Code) of the listed issuer (other than at the level of its subsidiaries); or
- (b) acquisition(s) of assets from a person or a group of persons or any of his/their associates pursuant to an agreement, arrangement or understanding entered into by the listed issuer within 24 months of such person or group of persons gaining control (as defined in the Takeovers Code) of the listed issuer (other than at the level of its subsidiaries), where such gaining of control had not been regarded as a reverse takeover, which individually or together constitute(s) a very substantial acquisition.”.

8 Rule 14.54 provides that:

the Exchange will treat a listed issuer proposing a reverse takeover as if it were a new listing applicant. The enlarged group or the assets to be acquired must be able to meet the requirements of rule 8.05 and the enlarged group must be able to meet all the other basic conditions set out in Chapter 8 of the Exchange Listing Rules.

9 Rule 14.82 provides that:

Where for any reason (including immediately after completion of a notifiable transaction or connected transaction) the assets of a listed issuer ... consist wholly or substantially of cash or short-dated securities, it will not be regarded as suitable for listing and trading in its securities will be suspended. "Short-dated securities" means securities such as bonds, bills or notes which have less than 1 year to maturity.

10 Rule 14.84 states that:

The listed issuer may apply to the Exchange to lift the suspension once it has a business suitable for listing. The Exchange will treat its application for lifting of the suspension as if it were an application for listing from a new applicant. The listed issuer will be required, among other things, to issue a listing document containing the specific information required by Appendix I Part A, and pay the non-refundable initial listing fee. The Exchange reserves the right to cancel the listing if such suspension continues for more than 12 months or in any other case where it considers it necessary. It is therefore advisable to consult the Exchange at the earliest possible opportunity in each case.

ANALYSIS

Whether Company A was a cash company

11 Rule 14.82 defines a cash company as an issuer whose assets consist wholly or substantially of cash or short-dated securities for any reason.

12 Despite the revised fund raising method, Company A's assets would still substantially consist of cash immediately after completion of the Second Placing. Company A's proposal to redeem the convertible notes if the Acquisition failed to complete would not address the Exchange's concern as the company would have already become a cash company. Under Rule 14.83, trading in its shares would be suspended.

- 13 In view of this, Company A revised the terms of the Second Placing to ensure that it would not become a cash company at any time. Under the revised terms, the Second Placing was conditional on completion of the Acquisition.

Whether the Exchange would treat the Acquisition as a reverse takeover

- 14 Rule 14.06(6) seeks to prevent circumvention of the new listing requirements. Its introductory paragraph defines “reverse takeover” as an acquisition or a series of acquisitions which represents, in the Exchange’s opinion, an attempt to (i) list the assets to be acquired and (ii) circumvent the new listing requirements. Rules 14.06(6)(a) and (b) provide bright line tests which apply to two specific forms of reverse takeover. They are not meant to be exhaustive. Therefore, transactions which are in substance backdoor listings but fall outside sub-rules (a) and (b) could still be treated as reverse takeovers. This, in practice, has been applied only to extreme cases (see the Listing Committee Annual Report 2009).
- 15 The Exchange noted that the size of the Acquisition was very significant to Company A, and the Target was in a completely different business. Despite Company A’s stated intention to continue its existing businesses, they would become immaterial after the Acquisition. The Acquisition would result in a change in Company A’s dominant business and was a means to achieve the listing of the Target’s business. The Acquisition was an extreme case.
- 16 Company A submitted that the Acquisition was not a reverse takeover as the Vendor would not acquire shares through the Acquisition. The Exchange did not consider this fact relevant. An acquisition is a reverse takeover under the introductory paragraph of Rule 14.06(6) if the Exchange is satisfied that it is an attempt to (i) list the assets to be acquired and (ii) circumvent the new listing requirements. In this case, the Exchange considered that the Acquisition was an attempt to achieve a listing of the Target’s business.
- 17 Nevertheless, the Exchange took into account the following factors when assessing whether the Acquisition was “a means to circumvent the requirements for new applicants set out in Chapter 8 of the Exchange Listing Rules”.
- a. The Target would have been able to meet the profit requirement for new applicants under Rule 8.05(1)(a) but for the substantial loss it suffered in the latest financial year as a result of a global economic downturn. The Target’s results showed that there was no significant deterioration in its revenue generating ability in the latest financial year and that its trading record was only adversely affected temporarily by the economic downturn.
 - b. Given its substantial asset value and revenue for its latest financial year, the Target should be able to meet the capitalisation/revenue test under Rule 8.05(3).

- 18 On balance, the Exchange decided not to treat the Acquisition as a reverse takeover on the following conditions:
- a. Company A would publish the circular with a disclosure standard comparable to an IPO prospectus.
 - b. In the circular, Company A would fully explain, to the Exchange's satisfaction, the Target's loss in the latest year to show that it was temporary in nature and was not due to a fundamental deterioration of commercial or operational viability of the Target; and
 - c. Company A would appoint an adviser acceptable to the Exchange to conduct due diligence on the Target and to fulfill duties and obligations equivalent to those of a sponsor for a new listing application under the Rules including Practice Note 21.
- 19 Given this, the Exchange considered that the purpose of the reverse takeover rule was satisfied.

CONCLUSION

- 20 Company A was not a cash company after revising the terms of the Second Placing.
- 21 The Exchange did not treat the Acquisition as a reverse takeover subject to the conditions in paragraph 18.