HKEx LISTING DECISION
Cite as HKEx-LD52-4 (March 2006) (Withdrawn in January 2024)

Summary	
Name of Parties	Company A – a Main Board listing applicant and its subsidiaries (the 'Group') Investor A – a professional fund manager and a pre-IPO investor in which none of directors of Company A had beneficial interest
Subject	Whether the shares of Company A issued to a pre-IPO investor should be subject to a compulsory lock-up and be counted towards part of the public float where (a) the shares were converted shortly before listing from convertible notes subscribed by such investor in the prior year period; and (b) the effective subscription cost of the shares was at a deep discount to the proposed offer price of the shares?
Listing Rules	Listing Rules 8.24 and 10.07(1)(a); Listing Decision HKEx-LD36-1 (October, 2003)
Decision	In light of the circumstances of the case, in particular the fact that the convertible notes had been subscribed, and the conversion ratio set, more than one year prior to the application for listing, the Exchange determined that the shares issued to a pre-IPO investor upon conversion of convertible notes shortly before listing would not be subject to a compulsory lock-up and could be treated as part of the public float.

SUMMARY OF FACTS

1. Investor A became a shareholder of Company A about one month prior to the submission of Company A's listing application. The shares were issued to Investor A upon the exercise of its conversion rights under certain convertible notes ('Convertible Notes') held by Investor A approximately 15 months prior to the submission of the listing application of Company A.

2. Immediately after the initial public offering of Company A, Investor A would hold less than 5% of the issued share capital of Company A. Save for its passive investment in Company A, Investor A was not a connected person of Company A and was not directly involved in management decisions of the Group. However, Investor A had voluntarily undertaken to the underwriters and Company A that during the period of three months from the date of listing, it would not directly or

indirectly transfer or otherwise dispose of any shares that it held as at the date of listing.

3. The effective cost paid by Investor A for each share was substantially lower than the proposed IPO price (at a deep discount of nearly 80% to the proposed offer price of the shares).

4. The sponsors submitted the following reasons justifying the deep discount to the proposed IPO price:

   a. the investment history of Investor A in the Group started almost 5 years prior to the application for listing when it subscribed a number of conversion notes issued by Company A's predecessor (the 'First Notes') and which were subsequently redeemed by Company A's predecessor;

   b. shortly after redemption of the First Notes, Company A's predecessor issued the Convertible Notes to Investor A around the time of the SARS epidemic. While the conversion multiple was fixed at the time of the issue of the Convertible Notes, the conversion formula of the Convertible Notes was based on the conversion formula set at the time of the First Notes (that is, 5 years prior to the application for listing); and

   c. the conversion of the Convertible Notes was in accordance with the original terms and conditions agreed at the time of investment.

THE ISSUE RAISED FOR CONSIDERATION

5. Whether the shares of Company A issued to by a pre-IPO investor should be subject to a compulsory lock-up and be counted towards part of the public float where (a) the shares were converted shortly before listing from convertible notes subscribed by such investor in prior year period; and (b) the effective subscription cost of the shares was at a deep discount to the proposed offer price of the shares?

APPLICABLE LISTING RULES OR PRINCIPLE

6. Listing Rule 8.08(1)(a) provides that:

> at least 25% of the issuer's total issued share capital must at all times be held by the public.

7. Listing Rule 8.24 states that the Exchange will not regard any connected person of the issuer as a member of 'the public' or shares held by a connected person as being 'in public hands'. The rule further provides that the Exchange will not recognise as member of the 'public where:

(1) any person whose acquisition of securities has been financed directly or indirectly by a connected person; or

(2) any person who is accustomed to take instructions from a connected person in relation to the acquisition, disposal, voting or other disposition of securities of the issuer registered in his name or other held by him.

8. Listing Rule 10.07(1)(a) provides that:

> A person or group of persons shown by the listing document issued at the time of the issuer's application for listing to be controlling shareholders of the issuer shall not and shall procure that the relevant registered holder(s) shall not:-
>
> (a) …on the date which is 6 months from the date of on which dealings in the securities of a new applicant commence on the Exchange, dispose of…any of those securities of the issuer…

9. The Listing Decision, HKEx-LD36-1 (October, 2003) ('HKEx LD36-1') states regarding pre-IPO placing:

> The Exchange was of the view that, as a general principle on the Main Board, placings of shares shortly before a listing application should be permitted subject to full disclosure in the prospectus. However, the placee may be subject to a lock-up of his shares. The question of whether the placee should be subject to a lock-up is determined on a case-by-case basis having regard to all the circumstances of the case.

The decision also noted that:

> Furthermore, the Exchange would not regard any placee who is subject to a lock-up as a member of the public at the time of listing and for so long as the transferor and the placee together constitute a "group of persons who are together entitled to exercise or control the exercise of *[30 per cent]* or more of the voting power at general meetings of the issuer or who is or are in a position to control the composition of a majority of the board of directors of the issuer."

The decision further noted that:

- "shortly before a listing application" tends to be measured in terms of months rather than weeks and with the date of the listing application as reference point;
- the greater the amount of any discount to the IPO price and/or the greater the proximity in time of the placing to the date of the listing application, the greater would be the doubt as to the genuine nature of the transaction such that a lock-up of the shares would be warranted;

THE ANALYSIS

10. In considering whether shares placed pursuant to pre-IPO placings should be subject to lock-up and be counted towards the public float, the approach sets out in HKEx-LD36-1 was adopted in the present case. The most important single factor in the Exchange's analysis of HKEx-LD36-1 is whether a pre-IPO placing is conducted to circumvent the compulsory lock-up requirement. The Exchange is also of the view that the commercial decision of the listing applicant or the underwriter whether to impose a voluntary lock-up on the shares held by some placees is not a relevant consideration.

11. Following the above analysis, the Exchange considered it relevant to take into account the following factors in its analysis:

    a. <u>Timing of the placing</u> – Although Investor A became the shareholder of Company A shortly prior to submission of the listing application, the conversion multiple had been fixed much earlier, i.e. more than one year prior to the application for listing. The Exchange considered that it was more relevant to look at the timing when the Convertible Notes were issued than the timing for the conversion of the Convertible Notes;

    b. <u>Deep discount</u> – As explained above, the deep discount of nearly 80% had been the result of an investment decision made more than one year prior to application for listing and in a different set of economic conditions;

    c. <u>Purpose of the placing</u> – The Exchange noted that the issue of new shares to Investor A had not brought about a change in the identity of controlling shareholders in Company A. Therefore, the Exchange did not see that the issue of Convertible Notes and their subsequent conversions had been for the purpose of circumventing the compulsory lock-up requirement as applicable to controlling shareholders. Instead, the Exchange noted that the issue of the Convertible Notes had been for the purpose of providing the necessary funding for the Group's expansion;

d. New/old shares – Whether the shares held by Investor A were new shares or old shares were of limited relevance in the Exchange's analysis.

THE DECISION

12. In light of the circumstances of the case, in particular the fact that the convertible notes had been subscribed, and the conversion ratio set, more than one year prior to the application for listing, the Exchange determined that the shares issued to a pre-IPO investor upon conversion of convertible notes shortly before listing would not be subject to a compulsory lock-up and could be treated as part of the public float.