HKEx LISTING DECISION
HKEx-LD21-2011 (updated in October 2019 (Rule amendments))

Party	Company A – a Main Board issuer The Target – a jointly controlled entity owned by Company A and certain third parties The Group – Company A and its subsidiaries
Issues	Whether the Exchange would accept Company A's proposed alternative size tests to classify its disposal of interest in the Target as a discloseable transaction instead of a very substantial disposal
Listing Rules	Main Board Rule 14.20
Decision	The Disposal was a very substantial disposal for Company A

FACTS

1. Company A owned 40 per cent interest in the Target. It recorded the Target's results using the equity method of accounting.

2. Based on the Group's latest accounts, the share of net assets and profits from the Target represented about 50 per cent and 90 per cent of the Group's total assets and net profits.

The proposal

3. The Target would undergo a restructuring to comply with the Mainland regulations, which would involve a reduction of Company A's shareholding in the Target. The parties therefore proposed that:

   - Company A would sell a 7 per cent interest in the Target to third party purchaser(s) (the **Disposal**); and

   - the Target would issue new shares to third party investors to enlarge its capital base (the **Capital Increase**).

4. The Disposal and Capital Increase were separate transactions. Together they would reduce Company A's shareholding in the Target to about 15 per cent, which would be treated as an investment in the Group's accounts.

5. The Capital Increase would not be a deemed disposal by Company A because the Target was not its subsidiary.

Issues

6. For the Disposal, the profits and consideration ratios were less than 25 per cent whereas the assets and revenue ratios exceeded 75 per cent. Accordingly, it would be a very substantial disposal for Company A and subject to shareholders' approval.

7. Company A submitted that the assets and revenue ratios were anomalous. It was not meaningful to compare 7 per cent of the Target's assets and revenue with those of the Group as shown in its accounts because the Target was engaging in a business different from those of the Group, and the Target's assets and revenue were not consolidated in the Group's accounts.

8. It proposed to compare 7 per cent of the Target's assets/revenue with the Group's total assets/revenue adjusted by its proportionate interests in the assets/revenue of the Target and other jointly controlled entities. It also proposed to compare 7 per cent of the Target's net assets with the Group's net assets. Based on these alternative size tests, the Disposal should be classified as a discloseable transaction.

APPLICABLE LISTING RULES

9. Rule 14.01 states that:

> This Chapter deals with certain transactions, principally acquisitions and disposals, by a listed issuer. …

10. Rule 14.07(1) provides the calculation of an assets ratio as follows:

> the total assets which are the subject of the transaction divided by the total assets of the listed issuer…

11. Rule 14.07(3) provides the calculation of a revenue ratio as follows:

> the revenue attributable to the assets which are the subject of the transaction divided by the revenue of the listed issuer…

12. Rule 14.20 states that:

> the Exchange may, where any of the calculations of the percentage ratios produces an anomalous result or is inappropriate to the sphere of activity of the listed issuer, disregard the calculation and substitute other relevant indicators of size, including industry specific tests. The listed issuer must provide alternative tests which it considers appropriate to the Exchange for consideration.

ANALYSIS

13. Chapter 14 governs an issuer's transactions, including acquisitions or disposals of assets having material impacts on its financial position.

14. Rule 14.07 sets out five percentage ratios for assessing the impact of a transaction on an issuer. They form the basis for classifying the transaction which determines whether the transaction is subject to any disclosure and/or shareholders' approval requirements under Chapter 14.

15. In this case, the Exchange noted that:

- The Target was a material joint venture of Company A having regard to its contributions to the Group's net assets (50 per cent) and net profits (90 per cent). Company A had disclosed the Target's business as one of Company A's principal businesses in its financial reports.

- The Disposal formed part of a proposal to reduce Company A's interest in the Target. When classifying the Disposal, it was necessary to consider the overall impact of the Target's restructuring on the Group.

- The Disposal and the Capital Increase together would result in the Target ceasing to be a joint venture of Company A. As the proposal would have a significant impact on the Group's business and financial position, it was appropriate to classify the Disposal as a very substantial disposal for Company A.

- Company A's proposed alternative size tests were not acceptable as they did not take into account the overall impact of the Target's restructuring on the Group.

CONCLUSION

16. The Disposal was a very substantial disposal for Company A.

Note: On 1 October 2019, Rule 14.20 was amended to clarify that if any calculation of the percentage ratio produces an anomalous results or is inappropriate to the sphere of activities of the issuer, the Exchange (or the issuer) may apply an alternative size test that it considers appropriate to assess the materiality of a transaction under Chapter 14.

The Rule amendments would not change the analysis and conclusion in this case.